

PRINCIPAL FINANCIAL GROUP INC
Form 10-Q
November 04, 2009
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

OR

- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
-

1-16725

(Commission file number)

PRINCIPAL FINANCIAL GROUP, INC.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

(Exact name of registrant as specified in its charter)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Delaware

(State or other jurisdiction of incorporation or organization)

42-1520346

(I.R.S. Employer Identification Number)

711 High Street, Des Moines, Iowa 50392

(Address of principal executive offices)

(515) 247-5111

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The total number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of October 28, 2009, was 318,943,811.

Table of Contents

PRINCIPAL FINANCIAL GROUP, INC.

TABLE OF CONTENTS

	Page
<u>Part I - FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements</u>	3
<u>Consolidated Statements of Financial Position at September 30, 2009 (Unaudited) and December 31, 2008</u>	3
<u>Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and 2008</u>	4
<u>Unaudited Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2009 and 2008</u>	5
<u>Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008</u>	6
<u>Notes to Unaudited Consolidated Financial Statements - September 30, 2009</u>	8
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	63
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	110
<u>Item 4.</u>	
<u>Controls and Procedures</u>	116
<u>Part II - OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	117
<u>Item 1A.</u>	
<u>Risk Factors</u>	117
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	117
<u>Item 6.</u>	
<u>Exhibits</u>	118
<u>Signature</u>	119

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.
Consolidated Statements of Financial Position

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

	September 30, 2009 (Unaudited)	December 31, 2008
	(in millions)	
Assets		
Fixed maturities, available-for-sale	\$ 45,683.6	\$ 40,117.2
Fixed maturities, trading	1,029.8	843.4
Equity securities, available-for-sale	218.4	242.7
Equity securities, trading	178.8	158.0
Mortgage loans	12,018.7	13,113.6
Real estate	1,024.9	919.4
Policy loans	899.6	896.4
Other investments	2,553.2	2,816.6
Total investments	63,607.0	59,107.3
Cash and cash equivalents	3,241.2	2,608.0
Accrued investment income	742.7	750.7
Premiums due and other receivables	1,135.8	988.1
Deferred policy acquisition costs	3,591.4	4,153.0
Property and equipment	496.8	518.2
Goodwill	382.6	375.5
Other intangibles	864.9	925.3
Separate account assets	61,518.7	55,142.6
Other assets	1,798.4	3,613.7
Total assets	\$ 137,379.5	\$ 128,182.4
Liabilities		
Contractholder funds	\$ 40,951.7	\$ 43,086.6
Future policy benefits and claims	18,938.0	18,494.2
Other policyholder funds	564.4	536.2
Short-term debt	107.1	500.9
Long-term debt	1,586.1	1,290.5
Income taxes currently payable	2.0	1.9
Deferred income taxes	116.1	102.8
Separate account liabilities	61,518.7	55,142.6
Other liabilities	5,988.7	6,457.4
Total liabilities	129,772.8	125,613.1
Stockholders' equity		
Series A preferred stock, par value \$.01 per share with liquidation preference of \$100 per share - 3.0 million shares authorized, issued and outstanding in 2009 and 2008		
Series B preferred stock, par value \$.01 per share with liquidation preference of \$25 per share - 10.0 million shares authorized, issued and outstanding in 2009 and 2008	0.1	0.1
Common stock, par value \$.01 per share - 2,500.0 million shares authorized, 446.9 million and 387.0 million shares issued, and 318.9 million and 259.3 million shares outstanding in 2009 and 2008	4.5	3.9
Additional paid-in capital	9,480.7	8,376.5
Retained earnings	4,180.2	3,722.5
Accumulated other comprehensive loss	(1,434.1)	(4,911.6)
Treasury stock, at cost (128.0 million and 127.7 million shares in 2009 and 2008, respectively)	(4,722.7)	(4,718.6)
Total stockholders' equity attributable to Principal Financial Group, Inc.	7,508.7	2,472.8
Noncontrolling interest	98.0	96.5
Total stockholders' equity	7,606.7	2,569.3
Total liabilities and stockholders' equity	\$ 137,379.5	\$ 128,182.4

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Operations

(Unaudited)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
(in millions, except per share data)				
Revenues				
Premiums and other considerations	\$ 932.9	\$ 1,049.7	\$ 2,820.5	\$ 3,258.9
Fees and other revenues	550.7	599.0	1,539.4	1,834.9
Net investment income	853.3	1,079.7	2,541.9	3,030.9
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	50.6	(20.9)	62.5	(145.0)
Total other-than-temporary impairment losses on available-for-sale securities	(162.5)	(209.7)	(510.0)	(323.1)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income	45.3		162.4	
Net impairment losses on available-for-sale securities	(117.2)	(209.7)	(347.6)	(323.1)
Net realized capital losses	(66.6)	(230.6)	(285.1)	(468.1)
Total revenues	2,270.3	2,497.8	6,616.7	7,656.6
Expenses				
Benefits, claims and settlement expenses	1,317.1	1,597.2	3,958.0	4,703.2
Dividends to policyholders	61.9	70.4	188.3	210.2
Operating expenses	643.0	723.7	1,894.1	2,217.0
Total expenses	2,022.0	2,391.3	6,040.4	7,130.4
Income before income taxes	248.3	106.5	576.3	526.2
Income taxes (benefits)	44.1	(2.2)	85.5	56.8
Net income	204.2	108.7	490.8	469.4
Net income attributable to noncontrolling interest	11.3	10.4	18.3	12.1
Net income attributable to Principal Financial Group, Inc.	192.9	98.3	472.5	457.3
Preferred stock dividends	8.2	8.2	24.7	24.7
Net income available to common stockholders	\$ 184.7	\$ 90.1	\$ 447.8	\$ 432.6
Earnings per common share				
Basic earnings per common share	\$ 0.58	\$ 0.35	\$ 1.54	\$ 1.67
Diluted earnings per common share	\$ 0.57	\$ 0.35	\$ 1.54	\$ 1.66

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Stockholders Equity

(Unaudited)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Noncontrolling interest	Total stockholders equity
(in millions)									
Balances at									
January 1, 2008	\$	\$ 0.1	\$ 3.9	\$ 8,295.4	\$ 3,414.3	\$ 420.2	\$ (4,712.2)	\$ 97.6	\$ 7,519.3
Common stock issued				31.5					31.5
Capital transactions of equity method investee, net of related income taxes				0.3					0.3
Stock-based compensation and additional related tax benefits				39.5					39.5
Treasury stock acquired, common							(6.4)		(6.4)
Dividends to preferred stockholders					(24.7)				(24.7)
Dividends to noncontrolling interest								(12.8)	(12.8)
Capital received from noncontrolling interest								3.2	3.2
Effects of changing post-retirement benefit plan measurement date, net of related income taxes					0.9	(2.0)			(1.1)
Comprehensive loss:									
Net income					457.3			12.1	469.4
Net unrealized losses, net						(2,282.8)			(2,282.8)
Foreign currency translation adjustment, net of related income taxes						(16.7)		(1.1)	(17.8)
Unrecognized post-retirement benefit obligation, net of related income taxes						(6.0)			(6.0)
Comprehensive loss									(1,837.2)
Balances at									
September 30, 2008	\$	\$ 0.1	\$ 3.9	\$ 8,366.7	\$ 3,847.8	\$ (1,887.3)	\$ (4,718.6)	\$ 99.0	\$ 5,711.6
Balances at									
January 1, 2009	\$	\$ 0.1	\$ 3.9	\$ 8,376.5	\$ 3,722.5	\$ (4,911.6)	\$ (4,718.6)	\$ 96.5	\$ 2,569.3
Common stock issued			0.6	1,122.4					1,123.0
Stock-based compensation and additional related tax benefits				27.7					27.7
Treasury stock acquired, common							(4.1)		(4.1)
Dividends to preferred stockholders					(24.7)				(24.7)
Dividends to noncontrolling interest								(5.4)	(5.4)
Purchase of subsidiary shares from noncontrolling interest				(45.9)				0.2	(45.7)
Capital paid to noncontrolling interest								(11.7)	(11.7)
Effects of reclassifying noncredit component of previously recognized impairment					9.9	(9.9)			

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

losses on fixed maturities, available-for-sale, net																	
Comprehensive income:																	
Net income				472.5						18.3				490.8			
Net unrealized gains, net									3,426.2					3,426.2			
Noncredit component of impairment losses on fixed maturities, available-for-sale, net									(99.0)					(99.0)			
Foreign currency translation adjustment, net of related income taxes									115.3		0.1			115.4			
Unrecognized post-retirement benefit obligation, net of related income taxes									44.9					44.9			
Comprehensive income														3,978.3			
Balances at																	
September 30, 2009	\$	\$	0.1	\$	4.5	\$	9,480.7	\$	4,180.2	\$	(1,434.1)	\$	(4,722.7)	\$	98.0	\$	7,606.7

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended			
	September 30,			
	2009		2008	
	(in millions)			
Operating activities				
Net income	\$	490.8	\$	469.4
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of deferred policy acquisition costs		70.4		212.6
Additions to deferred policy acquisition costs		(361.0)		(540.1)
Accrued investment income		8.0		(32.8)
Net cash flows from trading securities		(101.0)		(451.9)
Premiums due and other receivables		(106.1)		10.0
Contractholder and policyholder liabilities and dividends		1,189.6		1,747.0
Current and deferred income taxes (benefits)		128.0		(93.5)
Net realized capital losses		285.1		468.1
Depreciation and amortization expense		104.4		105.4
Mortgage loans held for sale, acquired or originated		(41.7)		(56.4)
Mortgage loans held for sale, sold or repaid, net of gain		49.4		52.1
Real estate acquired through operating activities		(25.1)		(50.7)
Real estate sold through operating activities		3.2		14.6
Stock-based compensation		26.9		32.8
Other		73.5		(19.4)
Net adjustments		1,303.6		1,397.8
Net cash provided by operating activities		1,794.4		1,867.2
Investing activities				
Available-for-sale securities:				
Purchases		(6,600.7)		(6,205.6)
Sales		3,770.5		524.5
Maturities		3,146.0		2,483.7
Mortgage loans acquired or originated		(271.8)		(1,682.3)
Mortgage loans sold or repaid		1,247.2		1,041.8
Real estate acquired		(50.2)		(20.6)
Real estate sold		22.1		68.7
Net purchases of property and equipment		(20.6)		(83.3)
Purchases of interest in subsidiaries, net of cash acquired		(45.7)		(20.3)
Net change in other investments		(40.6)		(124.9)
Net cash provided by (used in) investing activities	\$	1,156.2	\$	(4,018.3)

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Cash Flows (continued)

(Unaudited)

	For the nine months ended, September 30,	
	2009	2008
	(in millions)	
Financing activities		
Issuance of common stock	\$ 1,123.0	\$ 31.5
Acquisition of treasury stock	(4.1)	(6.4)
Proceeds from financing element derivatives	121.3	130.6
Payments for financing element derivatives	(57.7)	(91.3)
Excess tax benefits from share-based payment arrangements	0.2	2.8
Dividends to preferred stockholders	(24.7)	(24.7)
Issuance of long-term debt	745.1	6.4
Principal repayments of long-term debt	(465.9)	(17.3)
Net proceeds (repayments) of short-term borrowings	(397.4)	63.9
Investment contract deposits	3,438.2	9,852.4
Investment contract withdrawals	(6,871.1)	(7,160.6)
Net increase in banking operation deposits	80.2	293.0
Other	(4.5)	(4.6)
Net cash provided by (used in) financing activities	(2,317.4)	3,075.7
Net increase in cash and cash equivalents	633.2	924.6
Cash and cash equivalents at beginning of period	2,608.0	1,344.4
Cash and cash equivalents at end of period	\$ 3,241.2	\$ 2,269.0

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2009

(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (PFG), its majority-owned subsidiaries and its consolidated variable interest entities (VIEs), have been prepared in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2009, are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2008, included in our Form 10-K for the year ended December 31, 2008, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2008, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

We have evaluated subsequent events through November 4, 2009, which was the date our consolidated financial statements were issued.

Reclassifications have been made to prior period financial statements to conform to the September 30, 2009, presentation. See Recent Accounting Pronouncements for impact of new accounting guidance on prior period financial statements.

Recent Accounting Pronouncements

On September 30, 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-12, Fair Value Measurements and Disclosures (Topic 820), *Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)* (ASU 2009-12). ASU 2009-12 provides guidance on measuring the fair value of certain alternative investments, and amends Accounting Standards Codification (ASC) Topic 820 to offer investors a practical means for measuring the fair value of investments in certain entities that calculate net asset value per share. ASU 2009-12 is effective for periods ending after December 15, 2009. We are evaluating the impact this guidance will have on our consolidated financial statements.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

On August 28, 2009, the FASB issued ASU No. 2009-05, Fair Value Measurements and Disclosures (Topic 820), *Measuring Liabilities at Fair Value* (ASU 2009-05), to provide additional guidance on measuring the fair value of liabilities. ASU 2009-05 clarifies that the quoted price for the identical liability, when traded as an asset in an active market, is also a Level 1 measurement for that liability when no adjustment to the quoted price is required. In the absence of a quoted price in an active market, an entity must use one or more of the following valuation techniques to estimate fair value: (1) a valuation technique that uses a quoted price: (a) of an identical liability when traded as an asset or (b) of a similar liability when traded as an asset; (2) another valuation technique such as (a) a present value technique or (b) a technique based on the amount an entity would pay to transfer the identical liability or would receive to enter into an identical liability. ASU 2009-05 will be effective for us for fourth quarter 2009 reporting and is not expected to have a material impact on our consolidated financial statements.

On June 30, 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*, which was subsequently incorporated into ASC Subtopic 105-10, *Generally Accepted Accounting Principles Overall*. This guidance replaces *The Hierarchy of Generally Accepted Accounting Principles* and establishes the *FASB Accounting Standards Codification™* (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. All guidance contained in the Codification carries an equal level of authority. This guidance was effective for financial statements issued for interim and annual periods ending after September 15, 2009, and did not have a material impact on our consolidated financial statements.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

1. Nature of Operations and Significant Accounting Policies (continued)

On June 12, 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140* (SFAS 166). The objective of SFAS 166 is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement in transferred financial assets. The most significant change is the elimination of the concept of a qualifying special-purpose entity. Therefore, formerly qualifying special-purpose entities (as defined under previous accounting standards) should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. SFAS 166 will be effective for us on January 1, 2010. Earlier adoption is prohibited. We are evaluating the impact this guidance will have on our consolidated financial statements.

Also on June 12, 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 amends FASB Interpretation No. 46(R), to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has (1) the power to direct the activities of a VIE that most significantly impact the enterprise's economic performance and (2) the obligation to absorb losses of the enterprise that could potentially be significant to the VIE or the right to receive benefits from the enterprise that could potentially be significant to the VIE. SFAS 167 requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. In addition, SFAS 167 requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a VIE. The enhanced disclosures are required for any enterprise that holds a variable interest in a VIE. SFAS 167 will be effective for us on January 1, 2010. Earlier adoption is prohibited. We are evaluating the impact this guidance will have on our consolidated financial statements.

On April 9, 2009, the FASB issued FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2), which was subsequently incorporated into ASC Subtopic 320-10, *Investments - Debt and Equity Securities - Overall*. This new guidance relates to the recognition and presentation of an other-than-temporary impairment (OTTI) and requires additional disclosures. The recognition provisions apply only to debt securities classified as available-for-sale and held-to-maturity, while the presentation and disclosure requirements apply to both debt and equity securities. An impaired debt security will be considered other-than-temporarily impaired if a holder has the intent to sell, or it more likely than not will be required to sell prior to recovery of the amortized cost. If a holder of a debt security does not expect recovery of the entire cost basis, even if there is no intention to sell the security, it will be considered an OTTI as well. This guidance also changes how an entity recognizes an OTTI for a debt security by separating the loss between the amount representing the credit loss and the amount relating to other factors, if a holder does not have the intent to sell or it more likely than not will not be required to sell prior to recovery of the amortized cost less any current period credit loss. Credit losses will be recognized in net income and losses relating to other factors will be recognized in other comprehensive income (OCI). If the holder has the intent to sell or it more likely than not will be required to sell before its recovery of amortized cost less any current period credit loss, the entire OTTI will continue to be recognized in net income. Furthermore, this guidance requires a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption with a corresponding adjustment to accumulated OCI. We adopted this guidance effective January 1, 2009. The cumulative change in accounting principle from adopting this guidance resulted in a net \$9.9 million increase to retained earnings and a corresponding decrease to accumulated OCI. The required disclosures have been included in our consolidated financial statements.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

On April 9, 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which was subsequently incorporated into ASC Subtopic 820-10, *Fair Value Measurements and Disclosures - Overall*. This guidance provides additional information on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability and clarifies that the use of multiple valuation techniques may be appropriate. It also provides additional guidance on circumstances that may indicate a transaction is not orderly. Further, it requires additional disclosures about fair value measurements in annual and interim reporting periods. We adopted this guidance effective January 1, 2009, and it did not have a material impact on our consolidated financial statements. See Note 9, Fair Value of Financial Instruments, for further details.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

1. Nature of Operations and Significant Accounting Policies (continued)

Also on April 9, 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments*, which was subsequently incorporated into ASC Subtopic 825-10, *Financial Instruments - Overall*. This guidance extends the annual disclosure requirements of carrying value and estimated fair value of financial instruments to interim financial statements of public companies. We adopted this guidance effective April 1, 2009. The required disclosures have been included in Note 9, Fair Value of Financial Instruments.

On March 19, 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, which was subsequently incorporated into ASC Subtopic 815-10, *Derivatives and Hedging - Overall*. This guidance requires (1) qualitative disclosures about objectives and strategies for using derivatives, (2) quantitative disclosures about fair value amounts of gains and losses on derivative instruments and related hedged items and (3) disclosures about credit-risk-related contingent features in derivative instruments. The disclosures are intended to provide users of financial statements with an enhanced understanding of how and why derivative instruments are used, how they are accounted for and the financial statement impacts. We adopted these changes on January 1, 2009. See Note 3, Derivative Financial Instruments, for further details.

On December 4, 2007, the FASB issued SFAS No. 141(R), *Business Combinations*, which was subsequently incorporated into ASC Subtopic 805-10, *Business Combinations-Overall*. Among the changes, the standard requires that the acquiring entity in a business combination establish the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, including any noncontrolling interests, and requires the acquirer to disclose additional information needed to more comprehensively evaluate and understand the nature and financial effect of the business combination. In addition, direct acquisition costs are to be expensed. We adopted this guidance on January 1, 2009, and all requirements are applied prospectively.

Also on December 4, 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of Accounting Research Bulletin No. 51*, which was subsequently incorporated into ASC Subtopic 815-10, *Consolidation-Overall*. The following changes to noncontrolling interests were mandated as part of this new guidance: (1) Noncontrolling interests are to be treated as a separate component of equity, rather than as a liability or other item outside of equity. (2) Net income includes the total income of all consolidated subsidiaries, with separate disclosures on the face of the statement of operations of the income attributable to controlling and noncontrolling interests. Previously, net income attributable to the noncontrolling interest was reported as an operating expense in arriving at consolidated net income. (3) This guidance revises the accounting requirements for changes in a parent's ownership interest when the parent retains control and for changes in a parent's ownership interest that results in deconsolidation. We adopted this guidance on January 1, 2009. Presentation and disclosure requirements have been applied retrospectively for all periods presented. All other requirements should be applied prospectively. Certain separate account arrangements involve ownership of mutual funds to support the investment objective of the separate account. It is possible that, through a separate account arrangement, greater than 50% of the mutual fund shares could be owned. The accounting guidance for this circumstance is not well defined, but we, like many other insurers, do not consolidate the mutual fund as we believe the arrangement qualifies for the exemption afforded investment companies. In January 2009, the FASB asked the Emerging Issues Task Force (EITF) to consider a topic entitled *Consideration of an Insurer's Accounting for Majority Owned Investments When the Ownership is through a Separate Account*. On September 30, 2009, the FASB issued proposed ASU *Financial Services - Insurance (Topic 944), Consideration of an Insurer's Accounting for Majority-Owned Investments When Ownership is Through a Separate Account*. The comment period for this proposed ASU ends on October 26, 2009, and while the final outcome is uncertain, the guidance as exposed supports our position.

Separate Accounts

As of September 30, 2009, and December 31, 2008, the separate accounts include a separate account valued at \$222.2 million and \$207.4 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. The separate account shares are recorded at fair value and are reported as separate account assets and separate account liabilities in the consolidated statements of financial position. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

2. Investments**Fixed Maturities and Equity Securities**

Fixed maturity securities include bonds, mortgage-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock and nonredeemable preferred stock. We classify fixed maturity securities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 9, Fair Value of Financial Instruments, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders' equity, net of adjustments related to deferred policy acquisition costs (DPAC), sales inducements, unearned revenue reserves, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to trading securities and hedged portions of available-for-sale securities in fair value hedging relationships are reflected in net income as net realized capital gains (losses).

The cost of fixed maturity securities is adjusted for amortization of premiums and accrual of discounts, both computed using the interest method. The cost of fixed maturity securities and equity securities is adjusted for other-than-temporary impairments recognized in net income. For loan-backed and structured securities, we recognize income using a constant effective yield based on currently anticipated prepayments using a tool that models the prepayment behavior of the underlying collateral based on the current interest rate environment.

The amortized cost, gross unrealized gains and losses, other-than-temporary impairments in OCI and fair value of fixed maturities and equity securities available-for-sale as of September 30, 2009, are summarized as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses (in millions)	Other-than- temporary impairments in OCI	Fair value
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 525.0	\$ 11.1	\$ 0.1	\$	\$ 536.0
Non-U.S. governments	725.6	101.2	2.0		824.8
States and political subdivisions	1,909.3	64.1	13.6		1,959.8
Corporate	32,625.3	1,410.1	1,405.0	21.3	32,609.1
Residential mortgage-backed securities	2,942.9	93.4	1.0		3,035.3
Commercial mortgage-backed securities	5,106.0	20.8	1,325.1	64.2	3,737.5
Collateralized debt obligations	607.0	1.0	242.1	40.3	325.6
Other debt obligations	2,954.2	36.0	280.6	54.1	2,655.5
Total fixed maturities, available-for-sale	\$ 47,395.3	\$ 1,737.7	\$ 3,269.5	\$ 179.9	\$ 45,683.6
Total equity securities, available-for-sale	\$ 255.4	\$ 12.9	\$ 49.9	\$	\$ 218.4

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The amortized cost and fair value of fixed maturities available-for-sale as of September 30, 2009, by contractual maturity, were as follows:

	Amo-rtized- cost (in millions)	Fair value
Due in one year or less	\$ 1,606.5	\$ 1,611.8
Due after one year through five years	13,265.5	13,598.9
Due after five years through ten years	9,300.1	9,341.0
Due after ten years	11,613.1	11,378.0
	35,785.2	35,929.7
Mortgage-backed and other asset-backed securities	11,610.1	9,753.9
Total	\$ 47,395.3	\$ 45,683.6

Actual maturities may differ because issuers may have the right to call or prepay obligations. Our portfolio is diversified by industry, issuer and asset class. Credit concentrations are managed to established limits.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

2. Investments (continued)**Net Realized Capital Gains and Losses**

Net realized capital gains and losses on sales of investments are determined on the basis of specific identification. In general, in addition to realized capital gains and losses on investment sales and periodic settlements on derivatives not designated as hedges, gains and losses related to other-than-temporary impairments, trading securities, certain seed money investments, fair value hedge and cash flow hedge ineffectiveness, mark-to-market adjustments on derivatives not designated as hedges, changes in the mortgage loan valuation allowance and impairments of real estate held for investment are reported as net realized capital gains (losses). Investment gains and losses on sales of certain real estate held for sale, which do not meet the criteria for classification as a discontinued operation, are reported as net investment income and are excluded from net realized capital gains (losses). The major components of net realized capital gains (losses) on investments are summarized as follows:

	For the three months ended September 30, 2009	For the nine months ended September 30, 2009
	(in millions)	
Fixed maturities, available-for-sale:		
Gross gains	\$ 43.8	\$ 107.4
Gross losses	(154.9)	(505.3)
Portion of impairment losses recognized in other comprehensive income	45.3	162.4
Hedging, net	68.3	(165.3)
Fixed maturities, trading	15.7	57.5
Equity securities, available-for-sale:		
Gross gains	12.6	25.1
Gross losses	(21.7)	(35.8)
Equity securities, trading	19.2	29.9
Mortgage loans	(39.2)	(115.8)
Derivatives	(64.5)	197.6
Other	8.8	(42.8)
Net realized capital losses	\$ (66.6)	\$ (285.1)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were \$2.1 billion and \$3.7 billion for the three and nine months ended September 30, 2009, respectively.

Other-Than-Temporary Impairments

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

We have a process in place to identify fixed maturity and equity securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers' credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Every month, all securities are reviewed to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

2. Investments (continued)

During first quarter 2009 we adopted FSP FAS 115-2, which changes the recognition and presentation of other-than-temporary impairments. See further discussion of the adoption in Note 1, Nature of Operations and Significant Accounting Policies. The recognition provisions within FSP FAS 115-2 apply only to debt securities classified as available-for-sale and held-to-maturity, while the presentation and disclosure requirements apply to both debt and equity securities.

Impairment losses on equity securities are recognized in net income. The way in which impairment losses on debt securities are recognized in the financial statements is dependent on the facts and circumstances related to the specific security. If we intend to sell a security or it is more likely than not that we would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, we recognize an other-than-temporary impairment in net income for the difference between amortized cost and fair value. If we do not expect to recover the amortized cost basis, we do not plan to sell the security and if it is not more likely than not that we would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, the recognition of the other-than-temporary impairment is bifurcated. We recognize the credit loss portion in net income and the noncredit loss portion in OCI.

We estimate the amount of the credit loss component of a debt security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or liquidations using bond specific facts and circumstances including timing, security interests and loss severity.

Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities, on fixed maturity securities were \$153.0 million and \$498.8 million for the three and nine months ended September 30, 2009, respectively. Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities, on equity securities were \$9.5 million and \$11.2 million for the three and nine months ended September 30, 2009, respectively.

The other-than-temporary impairments on fixed maturity securities for which an amount related to credit losses was recognized in net realized capital gains (losses) and an amount related to noncredit losses was recognized in OCI is summarized as follows:

**For the three months
ended September 30,
2009**

**For the nine months
ended September 30,
2009**

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

	(in millions)			
Total other-than-temporary impairments on fixed maturity securities for which an amount related to noncredit losses was recognized in OCI (1)	\$	(113.2)	\$	(312.5)
Noncredit loss recognized in OCI		45.3		162.4
Credit loss impairment recognized in net realized capital losses	\$	(67.9)	\$	(150.1)

(1) For the three and nine months ended September 30, 2009, total other-than-temporary impairment losses on available-for-sale securities reported in the consolidated statements of operations also include \$39.8 million and \$186.3 million, respectively, of impairment losses, net of recoveries from the sale of previously impaired securities, on fixed maturity securities and \$9.5 million and \$11.2 million, respectively, of impairment losses, net of recoveries from the sale of previously impaired securities, on equity securities for which total impairment losses are recognized in net income.

The following table provides a rollforward of credit losses on fixed maturity securities recognized in net income (bifurcated credit losses) for which a portion of an other-than-temporary impairment was recognized in OCI. The purpose of the table is to provide detail of (1) additions to the bifurcated credit loss amounts recognized for the period and (2) decrements for previously recognized bifurcated credit losses where the loss is no longer bifurcated and/or there has been a positive change in expected cash flows or accretion of the bifurcated credit loss amount.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

2. Investments (continued)

	For the three months ended September 30, 2009	For the nine months ended September 30, 2009
	(in millions)	
Beginning balance	\$ (100.6)	\$ (18.5)
Credit losses for which an other-than-temporary impairment was not previously recognized	(55.2)	(127.5)
Credit losses for which an other-than-temporary impairment was previously recognized	(14.0)	(24.2)
Reduction for credit losses previously recognized on securities now sold or intended to be sold	1.3	1.6
Reduction for positive changes in cash flows expected to be collected and amortization (1)	0.7	0.8
Ending balance	\$ (167.8)	\$ (167.8)

(1) Amounts are recognized in net investment income.

Gross Unrealized Losses for Fixed Maturities and Equity Securities

For fixed maturities and equity securities available-for-sale with unrealized losses, including other-than-temporary impairment losses reported in OCI, as of September 30, 2009, the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as follows:

	Less than twelve months		Greater than or equal to twelve months		Total	
	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
U.S. government and agencies	\$ 5.0	\$	\$ 1.0	\$ 0.1	\$ 6.0	\$ 0.1
Non-U.S. governments	7.1	0.1	35.6	1.9	42.7	2.0
States and political subdivisions	28.9	0.4	325.6	13.2	354.5	13.6
Corporate	1,073.1	60.6	9,737.5	1,365.7	10,810.6	1,426.3
	183.5	0.9	1.7	0.1	185.2	1.0

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Residential mortgage-backed securities

Commercial mortgage-backed securities	332.9	20.4	2,607.1	1,368.9	2,940.0	1,389.3
Collateralized debt obligations	0.2	1.8	322.1	280.6	322.3	282.4
Other debt obligations	150.5	15.1	1,141.4	319.6	1,291.9	334.7
Total fixed maturities, available-for-sale	\$ 1,781.2	\$ 99.3	\$ 14,172.0	\$ 3,350.1	\$ 15,953.2	\$ 3,449.4
Total equity securities, available-for-sale	\$ 38.1	\$ 21.7	\$ 99.0	\$ 28.2	\$ 137.1	\$ 49.9

Of the total amounts, Principal Life Insurance Company's (Principal Life) consolidated portfolio represented \$15,176.7 million in available-for-sale fixed maturity securities with gross unrealized losses of \$3,390.3 million. Principal Life's consolidated portfolio consists of fixed maturity securities where 82% are investment grade (rated AAA through BBB-) with an average price of 82 (carrying value/amortized cost) at September 30, 2009. Due to the credit disruption that began in the last half of 2007 and continued into 2009, which reduced liquidity and led to wider credit spreads, we saw an increase in unrealized losses in our securities portfolio. The unrealized losses were more pronounced in the Corporate sector and in structured products, such as commercial mortgage-backed securities, collateralized debt obligations and asset-backed securities (included in other debt obligations). During the second and third quarters of 2009, a narrowing of credit spreads and some improvement in liquidity resulted in a decrease in the unrealized losses in our securities portfolio relative to the period ended March 31, 2009.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

2. Investments (continued)

For those securities that have been in a loss position for less than twelve months, Principal Life's consolidated portfolio holds 156 securities with a carrying value of \$1,424.1 million and unrealized losses of \$88.3 million reflecting an average price of 94 at September 30, 2009. Of this portfolio, 92% was investment grade (rated AAA through BBB-) at September 30, 2009, with associated unrealized losses of \$67.1 million. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that have been in a continuous loss position greater than or equal to twelve months, Principal Life's consolidated portfolio holds 1,713 securities with a carrying value of \$13,752.6 million and unrealized losses of \$3,302.0 million. The average rating of this portfolio is A- with an average price of 81 at September 30, 2009. Of the \$3,302.0 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$1,368.8 million in unrealized losses with an average price of 66 and an average credit rating of AA-. The remaining unrealized losses consist primarily of \$1,318.0 million within the Corporate sector at September 30, 2009. The average price of the Corporate sector is 88 and the average credit rating is BBB. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because it is not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it is not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at September 30, 2009.

Net Unrealized Gains and Losses on Available-for-Sale Securities and Derivative Instruments

The net unrealized gains and losses on investments in fixed maturities available-for-sale, equity securities available-for-sale and derivative instruments are reported as a separate component of stockholders' equity. The cumulative amount of net unrealized gains and losses on available-for-sale securities and derivative instruments net of adjustments related to DPAC, sales inducements, unearned revenue reserves, changes in policyholder benefits and claims and applicable income taxes was as follows:

	September 30, 2009	
	(in millions)	
Net unrealized losses on fixed maturities, available-for-sale (1)	\$	(1,531.8)
Noncredit component of impairment losses on fixed maturities, available-for-sale		(162.4)
Net unrealized losses on equity securities, available-for-sale		(37.0)
Adjustments for assumed changes in amortization patterns		233.2

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Adjustments for assumed changes in liability for policyholder benefits and claims		(94.4)
Net unrealized gains on derivative instruments		47.7
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments		184.3
Provision for deferred income tax benefits		516.8
Effect of reclassifying noncredit component of previously recognized impairment losses on fixed maturities, available-for-sale, net		(9.9)
Net unrealized losses on available-for-sale securities and derivative instruments	\$	(853.5)

(1) Excludes net unrealized gains (losses) on hedged portions of fixed maturities, available-for-sale included in fair value hedging relationships.

Securities Posted as Collateral

We posted \$911.6 million in fixed maturity securities as of September 30, 2009, to satisfy collateral requirements primarily associated with a reinsurance arrangement and our derivative credit support annex (collateral) agreements. In addition, we posted \$1,822.0 million in commercial mortgage loans as of September 30, 2009, to satisfy collateral requirements associated with our obligation under funding agreements with the Federal Home Loan Bank of Des Moines.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments

Derivatives are generally used to hedge or reduce exposure to market risks associated with assets held or expected to be purchased or sold and liabilities incurred or expected to be incurred. Derivatives are used to change the characteristics of our asset/liability mix consistent with our risk management activities. Derivatives are also used in asset replication strategies. We do not buy, sell or hold these investments for trading purposes.

Types of Derivative Instruments

Interest Rate Contracts

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Sources of interest rate risk include the difference between the maturity and interest rate changes of assets with the liabilities they support, timing differences between the pricing of liabilities and the purchase or procurement of assets and changing cash flow profiles from original projections due to prepayment options embedded within asset and liability contracts. We use various derivatives to manage our exposure to fluctuations in interest rates.

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. Cash is paid or received based on the terms of the swap. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities arising from timing mismatches between assets and liabilities (including duration mismatches). We also use interest rate swaps to hedge against changes in the value of assets we anticipate acquiring and other anticipated transactions and commitments. Interest rate swaps are used to hedge against changes in the value of the guaranteed minimum withdrawal benefit (GMWB) liability. The GMWB rider on our variable annuity products provides for guaranteed minimum withdrawal benefits regardless of the actual performance of various equity and/or fixed income funds available with the product.

A swaption is an option to enter into an interest rate swap at a future date. We have written these options and received a premium in order to transform our callable liabilities into fixed term liabilities. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

In exchange-traded futures transactions, we agree to purchase or sell a specified number of contracts, the values of which are determined by the values of designated classes of securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. We enter into exchange-traded futures with regulated futures commissions merchants who are members of a trading exchange. We have used exchange-traded futures to reduce market risks from changes in interest rates and to alter mismatches between the assets in a portfolio and the liabilities supported by those assets.

A treasury lock is an agreement that allows the holder to lock in an interest rate. If the interest rate increases, the holder is entitled to receive a payment from the counterparty to the agreement equal to the present value of the difference in the current interest rate and the locked-in interest rate. If the interest rate decreases, the holder must pay the counterparty to the agreement an amount equal to the present value of the difference in the current interest rate and the locked-in interest rate. We have used treasury lock agreements to hedge against changes in the value of anticipated transactions and commitments.

Foreign Exchange Contracts

Foreign currency risk is the risk that we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements we issue, foreign currency-denominated fixed maturity securities we invest in and our investment in and net income of our international operations. We may use currency swaps and currency forwards to hedge foreign currency risk.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Currency swaps are contracts in which we agree with other parties to exchange, at specified intervals, a series of principal and interest payments in one currency for that of another currency. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. The interest payments are primarily fixed-to-fixed rate; however, may also be fixed-to-floating rate or floating-to-fixed rate. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date. We use currency swaps to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell.

Currency forwards are contracts in which we agree with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell. We have also used currency forwards to hedge the currency risk associated with net investments in foreign operations.

Equity Contracts

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in common stock. We use various derivatives to manage our exposure to equity risk, which arises from products in which the interest we credit is tied to an external equity index as well as products subject to minimum contractual guarantees.

We may sell an investment-type insurance contract with attributes tied to market indices (an embedded derivative as noted below), in which case we write an equity call option to convert the overall contract into a fixed-rate liability, essentially eliminating the equity component altogether. We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity products that credit interest based on changes in an external equity index. We use exchange-traded futures and equity put options to hedge against changes in the value of the GMWB liability related to the GMWB rider on our variable annuity product, as previously explained.

Credit Contracts

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in our investment portfolio. Credit derivatives are

used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name's credit spread at the time the agreement is executed. In cases where we sell protection, at the same time we enter into these synthetic transactions, we buy a quality cash bond to match against the credit default swap. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Other Contracts

Commodity Swaps. Commodity swaps are used to sell or buy protection on commodity prices in return for receiving or paying a quarterly premium. We purchased secured limited recourse notes from VIEs that are consolidated in our financial results. These VIEs use a commodity swap to enhance the return on an investment portfolio by selling protection on a static portfolio of commodity trigger swaps, each referencing a base or precious metal. The portfolio of commodity trigger swaps is a portfolio of deep out-of-the-money European puts on various base or precious metals. The VIEs provide mezzanine protection that the average spot rate will not fall below a certain trigger price on each commodity trigger swap in the portfolio and receive guaranteed quarterly premiums in return until maturity. At the same time the VIEs enter into this synthetic transaction, they buy a quality cash bond to match against the commodity swaps.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Embedded Derivatives. We purchase or issue certain financial instruments or products that contain a derivative instrument that is embedded in the financial instrument or product. When it is determined that the embedded derivative possesses economic characteristics that are not clearly or closely related to the economic characteristics of the host contract and a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is bifurcated from the host for measurement purposes. The embedded derivative, which is reported with the host instrument in the consolidated statements of financial position, is carried at fair value.

We sell investment-type insurance contracts in which the return is tied to an external equity index, a leveraged inflation index or leveraged reference swap. We economically hedge the risk associated with these investment-type insurance contracts.

We offer group benefit plan contracts that have guaranteed separate accounts as an investment option. We also offer a guaranteed fund as an investment option in our defined contribution plans in Hong Kong.

We have structured investment relationships with trusts we have determined to be VIEs, which are consolidated in our financial statements. The notes issued by these trusts include obligations to deliver an underlying security to residual interest holders and the obligations contain an embedded derivative of the forecasted transaction to deliver the underlying security.

We have fixed deferred annuities that credit interest based on changes in an external equity index. We also have certain variable annuity products with a GMWB rider, which provides that the contractholder will receive at least their principal deposit back through withdrawals of up to a specified annual amount, even if the account value is reduced to zero. Declines in the equity market may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these annuity contracts.

Exposure

Our risk of loss is typically limited to the fair value of our derivative instruments and not to the notional or contractual amounts of these derivatives. Risk arises from changes in the fair value of the underlying instruments. We are also exposed to credit losses in the event of nonperformance of the counterparties. Our current credit exposure is limited to the value of derivatives that have become favorable to us. This credit risk is minimized by purchasing such agreements from financial institutions with high credit ratings and by establishing and monitoring exposure limits. We also utilize various credit enhancements, including collateral and credit triggers to reduce the credit exposure to our derivative instruments.

Our derivative transactions are generally documented under International Swaps and Derivatives Association, Inc. Master Agreements. Management believes that such agreements provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, we are permitted to set off our receivable from a counterparty against our payables to the same counterparty arising out of all included transactions. For reporting purposes, we do not offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements.

We posted \$301.9 million and \$372.8 million in cash and securities under collateral arrangements as of September 30, 2009, and December 31, 2008, respectively, to satisfy collateral requirements associated with our derivative credit support agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the rating on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position as of September 30, 2009, and December 31, 2008, was \$1,395.8 million and \$2,100.0 million, respectively, for which we posted collateral of \$301.9 million and \$372.8 million, respectively, in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on September 30, 2009, we would be required to post an additional \$45.4 million of collateral to our counterparties.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

As of September 30, 2009, and December 31, 2008, we had received \$365.6 million and \$262.9 million, respectively, of cash collateral associated with our derivative credit support annex agreements. The cash collateral is included in other assets on the consolidated statements of financial position, with a corresponding liability reflecting our obligation to return the collateral recorded in other liabilities.

Notional amounts are used to express the extent of our involvement in derivative transactions and represent a standard measurement of the volume of our derivative activity. Notional amounts represent those amounts used to calculate contractual flows to be exchanged and are not paid or received, except for contracts such as currency swaps. Credit exposure represents the gross amount owed to us under derivative contracts as of the valuation date. The notional amounts and credit exposure of our derivative financial instruments by type were as follows:

	September 30, 2009		December 31, 2008	
	(in millions)			
Notional amounts of derivative instruments				
<i>Interest rate contracts:</i>				
Interest rate swaps	\$	23,287.3	\$	24,148.6
Futures		27.3		97.3
Swaptions				94.8
<i>Foreign exchange contracts:</i>				
Foreign currency swaps		5,409.6		6,298.7
Currency forwards		91.6		52.1
<i>Equity contracts:</i>				
Options		824.7		797.5
Futures		80.3		63.6
<i>Credit contracts:</i>				
Credit default swaps		1,774.8		1,948.9
<i>Other contracts:</i>				
Embedded derivative financial instruments		3,208.3		2,938.6
Commodity swaps		40.0		40.0
Total notional amounts at end of period	\$	34,743.9	\$	36,480.1
Credit exposure of derivative instruments				
<i>Interest rate contracts:</i>				
Interest rate swaps	\$	791.6	\$	1,105.1
<i>Foreign exchange contracts:</i>				
Foreign currency swaps		591.9		562.5
Currency forwards		4.5		0.2
<i>Equity contracts:</i>				

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Options		173.0		222.1
<i>Credit contracts:</i>				
Credit default swaps		17.5		70.7
Total gross credit exposure		1,578.5		1,960.6
Less: collateral received		417.5		284.2
Net credit exposure	\$	1,161.0	\$	1,676.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

The fair value of our derivative instruments classified as assets and liabilities was as follows:

	Derivative assets (1)				Derivative liabilities (2)			
	September 30, 2009		December 31, 2008		September 30, 2009		December 31, 2008	
	(in millions)							
Derivatives designated as hedging instruments								
Interest rate contracts	\$	134.1	\$	250.8	\$	424.1	\$	819.2
Foreign exchange contracts		458.0		410.8		274.6		300.4
Total derivatives designated as hedging instruments	\$	592.1	\$	661.6	\$	698.7	\$	1,119.6
Derivatives not designated as hedging instruments								
Interest rate contracts	\$	556.1	\$	802.1	\$	436.9	\$	621.5
Foreign exchange contracts		109.8		121.3		77.5		155.1
Equity contracts		173.0		222.1				
Credit contracts		17.5		70.7		99.4		227.2
Other contracts						146.3		185.2
Total derivatives not designated as hedging instruments	\$	856.4	\$	1,216.2	\$	760.1	\$	1,189.0
Total derivative instruments	\$	1,448.5	\$	1,877.8	\$	1,458.8	\$	2,308.6

(1) The fair value of derivative assets is reported with other investments on the consolidated statements of financial position.

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of \$35.0 million and \$60.2 million as of September 30, 2009, and December 31, 2008, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

When we sell credit protection, we are exposed to the underlying credit risk similar to purchasing a fixed maturity security instrument. The majority of our credit derivative contracts sold reference a single name or reference security (referred to as single name credit default swaps). The remainder of our credit derivatives reference either a basket or index of securities. These instruments are either referenced in an over-the-counter credit derivative transaction, or embedded within an investment structure that has been fully consolidated into our financial statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by \$47.0 million and \$60.8 million as of September 30, 2009, and December 31, 2008, respectively. These credit derivative transactions had a net fair value gain of \$3.9 million and \$21.2 million as of September 30, 2009, and December 31, 2008, respectively. Our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

We purchased certain investment structures with embedded credit features that are fully consolidated into our financial statements. This consolidation results in recognition of the underlying credit derivatives and collateral within the structure, typically high quality fixed maturity securities that are owned by a special purpose vehicle. These credit derivatives reference a single name or several names in a basket structure. In the event of default, the collateral within the structure would typically be liquidated to pay the claims of the credit derivative counterparty.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

The following tables show our credit default swap protection sold by types of contract, types of referenced/underlying asset class and external agency rating for the underlying reference security as of September 30, 2009, and December 31, 2008. The maximum future payments are undiscounted and have not been reduced by the effect of any offsetting transactions, collateral or recourse features described above.

	September 30, 2009			
	Notional amount	Fair value (in millions)	Maximum future payments	Weighted average expected life (in years)
Single name credit default swaps				
Corporate debt				
AA	\$ 140.0	\$ (1.5)	\$ 140.0	4.4
A	514.0	(0.7)	514.0	4.2
BBB	285.0	(2.2)	285.0	2.2
BB	35.0	(1.3)	35.0	1.8
Structured finance				
BBB	6.0	(5.7)	6.0	5.7
B	19.9	(14.9)	19.9	7.6
C	22.0	(20.1)	22.0	10.6
Total single name credit default swaps	1,021.9	(46.4)	1,021.9	3.8
Basket and index credit default swaps				
Corporate debt				
AAA	35.0	0.3	35.0	0.2
A	20.0	(0.2)	20.0	0.8
BBB	20.0	(0.1)	20.0	0.7
CCC	145.0	(12.1)	145.0	1.0
Near default	9.4	(9.4)	9.4	2.3
Government/municipalities				
AA	50.0	(10.4)	50.0	5.4
Structured finance				
AA	20.0	(5.7)	20.0	5.7
BBB	5.0	(1.2)	5.0	16.2
Total basket and index credit default swaps	304.4	(38.8)	304.4	2.2
Total credit default swap protection sold	\$ 1,326.3	\$ (85.2)	\$ 1,326.3	3.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

	December 31, 2008			
	Notional amount	Fair value (in millions)	Maximum future payments	Weighted average expected life (in years)
Single name credit default swaps				
Corporate debt				
AAA	\$ 10.0	\$ (1.0)	\$ 10.0	4.5
AA	135.0	(4.6)	135.0	5.4
A	554.0	(25.8)	554.0	4.8
BBB	305.0	(24.4)	305.0	2.7
BB	33.0	(1.4)	33.0	0.5
Structured finance				
A	9.9	(7.9)	9.9	3.5
BBB	16.0	(15.0)	16.0	22.5
BB	22.0	(18.1)	22.0	7.1
Total single name credit default swaps	1,084.9	(98.2)	1,084.9	4.4
Basket and index credit default swaps				
Corporate debt				
AAA	35.0	(0.2)	35.0	1.0
A	20.0	(1.4)	20.0	1.6
BBB	35.0	(16.3)	35.0	2.6
BB	130.0	(53.3)	130.0	1.5
CCC	20.0	(20.0)	20.0	3.0
Government/municipalities				
AA	50.0	(19.3)	50.0	6.2
Structured finance				
AA	25.0	(15.4)	25.0	8.6
Total basket and index credit default swaps	315.0	(125.9)	315.0	3.0
Total credit default swap protection sold	\$ 1,399.9	\$ (224.1)	\$ 1,399.9	4.1

We also have invested in available-for-sale fixed maturity securities that contain credit default swaps that do not require bifurcation. These securities are subject to the credit risk of the issuer, normally a special purpose vehicle, which consists of the underlying credit default swaps and high quality fixed maturity securities that serve as collateral. A default event occurs if the cumulative losses exceed a specified attachment point, which is typically not the first loss of the portfolio. If a default event occurs that exceeds the specified attachment point, our investment may not be fully returned. We would have no future potential payments under these investments. The following tables show by the types of referenced/underlying asset class and external rating of the available-for-sale fixed maturity security our fixed maturity securities with

nonbifurcated embedded credit derivatives as of September 30, 2009, and December 31, 2008.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

	September 30, 2009				Weighted average expected life (in years)
	Amortized cost		Carrying value		
(in millions)					
Corporate debt					
AAA	\$	15.0	\$	13.9	1.0
A		15.0		14.6	0.6
BBB		5.0		4.9	0.6
BB		35.0		27.1	5.3
B		25.0		16.6	3.7
CCC		26.5		22.6	5.2
CC		22.6		7.6	6.9
Total corporate debt		144.1		107.3	4.6
Structured finance					
AAA		9.5		5.6	2.6
AA		12.2		2.7	1.4
A		34.5		14.4	4.6
BBB		35.8		17.1	5.7
BB		41.0		19.1	7.5
B		15.4		0.8	5.4
CCC		8.1		1.2	8.5
Total structured finance		156.5		60.9	5.7
Total fixed maturity securities with credit derivatives	\$	300.6	\$	168.2	5.2

	December 31, 2008				Weighted average expected life (in years)
	Amortized cost		Carrying value		
(in millions)					
Corporate debt					
AAA	\$	55.0	\$	25.9	4.5
AA		5.0		4.0	1.3
A		35.0		19.0	3.1
BB		44.9		16.5	5.9
B		1.4		1.4	8.7
C		8.8		5.7	8.0

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Total corporate debt		150.1		72.5		5.4
Structured finance						
AAA		32.0		17.1		5.5
AA		47.4		18.4		5.6
A		66.0		15.1		5.5
BBB		34.4		14.4		6.5
BB		54.8		7.0		8.2
CCC		0.4		0.4		3.0
Total structured finance		235.0		72.4		6.1
Total fixed maturity securities with credit derivatives	\$	385.1	\$	144.9		5.8

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Fair Value Hedges

We use fixed-to-floating rate interest rate swaps to more closely align the interest rate characteristics of certain assets and liabilities. In general, these swaps are used in asset and liability management to modify duration, which is a measure of sensitivity to interest rate changes.

We enter into currency exchange swap agreements to convert certain foreign denominated assets and liabilities into U.S. dollar floating-rate denominated instruments to eliminate the exposure to future currency volatility on those items.

We also sell callable investment-type insurance contracts and use cancellable interest rate swaps and have written interest rate swaptions to hedge the changes in fair value of the callable feature.

The net interest effect of interest rate swap and currency swap transactions for derivatives in fair value hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

Hedge effectiveness testing for fair value relationships is performed utilizing a regression analysis approach for both prospective and retrospective evaluations. This regression analysis will consider multiple data points for the assessment that the hedge continues to be highly effective in achieving offsetting changes in fair value. In certain periods, the comparison of the change in value of the derivative and the change in the value of the hedged item may not be offsetting at a specific period in time due to small movements in value. However, any amounts recorded as fair value hedges have shown to be highly effective in achieving offsetting changes in fair value both for present and future periods.

The following tables show the effect of derivatives in fair value hedging relationships and the related hedged items on the consolidated statements of operations for the three and nine months ended September 30, 2009 and 2008. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in fair value	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, (1)	Hedged items in fair value	Amount of gain (loss) recognized in net income on related hedged item for the three months ended September 30, (1)
---------------------------	--	----------------------------	--

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

hedging relationships	2009		2008		hedging relationships	2009		2008	
	(in millions)					(in millions)			
Interest rate contracts	\$	(61.1)	\$	(65.0)	Fixed maturities securities, available-for-sale	\$	49.8	\$	70.6
Interest rate contracts		6.7		(3.0)	Investment-type insurance contracts		(4.1)		(6.5)
Foreign exchange contracts		9.3		17.1	Fixed maturities securities, available-for-sale		(10.5)		(16.7)
Foreign exchange contracts		(32.1)		(82.0)	Investment-type insurance contracts		8.5		86.8
Total	\$	(77.2)	\$	(132.9)	Total	\$	43.7	\$	134.2

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, (1)		Hedged items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the nine months ended September 30, (1)					
	2009	2008		2009	2008				
	(in millions)			(in millions)					
Interest rate contracts	\$	198.0	\$	(53.9)	Fixed maturities securities, available-for-sale	\$	(187.6)	\$	58.7
Interest rate contracts		(15.0)		(14.7)	Investment-type insurance contracts		27.1		2.5
Foreign exchange contracts		2.8		10.3	Fixed maturities securities, available-for-sale		(4.1)		(9.2)
Foreign exchange contracts		80.3		(132.8)	Investment-type insurance contracts		(89.9)		136.9
Total	\$	266.1	\$	(191.1)	Total	\$	(254.5)	\$	188.9

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

(1) The gain (loss) on both derivatives and hedged items in fair value relationships is reported in net realized capital gains (losses) on the consolidated statements of operations. The net amount represents the ineffective portion of our fair value hedges.

Periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships of fixed maturities securities, available-for-sale reported in net investment income on the consolidated statements of operations were \$37.7 million and \$20.9 million in losses for the three months ended September 30, 2009 and 2008, respectively, and \$101.4 million and \$46.3 million in losses for the nine months ended September 30, 2009 and 2008, respectively. Periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships of investment-type insurance contracts reported in benefits, claims and settlement expenses on the consolidated statements of operations were \$26.2 million and \$19.5 million in gains for the three months ended September 30, 2009 and 2008, respectively, and \$79.8 million and \$47.1 million in gains for the nine months ended September 30, 2009 and 2008, respectively.

Cash Flow Hedges

We utilize floating-to-fixed rate interest rate swaps to eliminate the variability in cash flows of recognized financial assets and liabilities and forecasted transactions. We have also utilized treasury lock agreements to eliminate the variability in cash flows of forecasted transactions.

We enter into currency exchange swap agreements to convert both principal and interest payments of certain foreign denominated assets and liabilities into U.S. dollar denominated fixed-rate instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in cash flow hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

The maximum length of time that we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 10.7 years. At September 30, 2009, we had \$81.6 million of gross unrealized gains reported in accumulated OCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from OCI into net income. No amounts were reclassified from OCI into net income as a result of the determination that hedged cash flows were probable of not occurring during the three months ended September 30, 2009. During the nine months ended September 30, 2009, \$40.4 million of gross unrealized losses were reclassified from OCI into net realized capital gains (losses) as a result of the determination that hedged cash flows of a forecasted liability

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

issuance were probable of not occurring. No amounts were reclassified from OCI into net income as a result of the determination that hedged cash flows were probable of not occurring during the three and nine months ended September 30, 2008.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

The following tables show the effect of derivatives in cash flow hedging relationships on the consolidated statements of operations and consolidated statements of financial position for the three and nine months ended September 30, 2009 and 2008. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in cash flow	Related hedged item	Amount of gain (loss) recognized in accumulated OCI on derivatives (effective portion) for the three months ended September 30,				Location of gain (loss) reclassified from accumulated OCI into net income (effective portion)	Amount of gain (loss) reclassified from accumulated OCI on derivatives (effective portion) for the three months ended September 30, (1)			
		2009		2008			2009		2008	
hedging relationships		(in millions)					(in millions)			
Interest rate contracts	Fixed maturity securities, available-for-sale	\$	(137.4)	\$	37.9	Net investment income	\$	0.9	\$	1.3
						Net realized capital losses		0.6		
Interest rate contracts	Investment-type insurance contracts		91.8		(7.0)	Benefits, claims and settlement expenses		(0.3)		
Interest rate contracts	Debt				(11.9)	Operating expense		(1.0)		
Foreign exchange contracts	Fixed maturity securities, available-for-sale		(63.4)		187.5	Net investment income				
Foreign exchange contracts	Investment-type insurance contracts		99.0		(332.9)	Benefits, claims and settlement expenses		(1.5)		
						Net realized capital losses				(0.5)
Total		\$	(10.0)	\$	(126.4)	Total	\$	(1.3)	\$	0.8

(1) Does not include derivative periodic settlements. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of fixed maturity securities, available-for-sale of \$4.7 million and \$2.9 million in gains were reported in net investment income on the consolidated statements of operations for the three months ended September 30, 2009 and 2008, respectively. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of investment-type insurance contracts of \$5.6 million and \$3.5 million in losses were reported in benefits, claims and settlement expenses on the consolidated statements of operations for the three months ended September 30, 2009 and 2008, respectively. We did not have any periodic settlements on interest rate contracts in cash flow hedging relationships of debt for the three months ended September 30, 2009 and 2008.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in accumulated OCI on derivatives (effective portion) for the nine months ended September 30,		Location of gain (loss) reclassified from accumulated OCI into net income (effective portion)	Amount of gain (loss) reclassified from accumulated OCI on derivatives (effective portion) for the nine months ended September 30, (1)	
		2009 (in millions)	2008		2009 (in millions)	2008
Interest rate contracts	Fixed maturity securities, available-for-sale	\$ (137.8)	\$ 93.5	Net investment income	\$ 3.3	\$ 2.9
Interest rate contracts	Investment-type insurance contracts	143.3	(3.4)	Benefits, claims and settlement expenses	(0.8)	
Interest rate contracts	Debt	30.6	(16.5)	Operating expense	(1.4)	0.2
Foreign exchange contracts	Fixed maturity securities, available-for-sale	(232.9)	117.0	Net investment income		
Foreign exchange contracts	Investment-type insurance contracts	171.2	(200.4)	Benefits, claims and settlement expenses	(4.1)	
				Net realized capital gains (losses)	22.9	(3.9)
Total		\$ (25.6)	\$ (9.8)	Total	\$ 19.9	\$ (0.8)

(1) Does not include derivative periodic settlements. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of fixed maturity securities, available-for-sale of \$12.8 million and \$6.1 million in gains were reported in net investment income on the consolidated statements of operations for the nine months ended September 30, 2009 and 2008, respectively. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of investment-type insurance contracts of \$14.7 million and \$7.0 million in losses were reported in benefits, claims and settlement expenses on the consolidated statements of operations for the nine months ended September 30, 2009 and 2008, respectively. We did not have any periodic settlements on interest rate contracts in cash flow hedging relationships of debt for the nine months ended September 30, 2009 and 2008.

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net loss resulting from the ineffective portion of interest rate contracts in cash flow hedging relationships was zero for both the three months ended September 30, 2009 and 2008, and zero and \$1.2 million for the nine months ended September 30, 2009 and 2008, respectively. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$1.6 million and \$1.9 million for the three months ended September 30, 2009 and 2008, respectively, and \$2.0 million and \$1.5 million for the nine months ended September 30, 2009 and 2008, respectively.

We expect to reclassify net losses of \$1.5 million from accumulated OCI into net income in the next 12 months, which includes both net deferred losses on discontinued hedges and periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)**Net Investment in Foreign Operations Hedges**

From time to time, we take measures to hedge our net investments in our foreign subsidiaries from currency risks. We did not use any currency forwards during 2009 or 2008 to hedge our net investment in foreign operations.

Derivatives Not Designated as Hedging Instruments

Our use of futures, certain swaptions and swaps, options and currency forwards are effective from an economic standpoint, but they have not been designated as hedges for financial reporting purposes. As such, periodic changes in the market value of these instruments, which includes unrealized gains and losses as well as periodic and final settlements, flow directly into net realized capital gains (losses).

The following tables show the effect of derivatives not designated as hedging instruments, including market value changes of embedded derivatives that have been bifurcated from the host contract, on the consolidated statements of operations for the three and nine months ended September 30, 2009 and 2008. Gains (losses) are primarily reported in net realized capital gains (losses) on the consolidated statements of operations.

	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30,				Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30,			
	2009		2008		2009		2008	
Derivatives not designated as hedging instruments	(in millions)							
Interest rate contracts	\$	41.0	\$	31.6	\$	(54.1)	\$	(6.9)
Foreign exchange contracts		(2.1)		(46.0)		93.9		(30.6)
Equity contracts		(16.1)		6.6		(84.6)		(0.7)
Credit contracts		12.6		(12.7)		60.9		(58.2)
Other contracts (1)		(8.9)		12.9		17.0		20.0
Total	\$	26.5	\$	(7.6)	\$	33.1	\$	(76.4)

(1) The gain for other contracts primarily includes the change in fair value of embedded derivatives.

4. Long-Term Debt

The components of long-term debt as of September 30, 2009, and December 31, 2008, were as follows:

	September 30, 2009		December 31, 2008	
	(in millions)			
8.2% notes payable, due 2009	\$		\$	454.9
3.31% notes payable, due 2011		56.2		49.9
3.63% notes payable, due 2011		28.8		25.6
7.875% notes payable, due 2014		400.0		
8.875% notes payable, due 2019		350.0		
6.05% notes payable, due 2036		601.8		601.8
8% surplus notes payable, due 2044		99.2		99.2
Non-recourse mortgages and notes payable		49.7		58.7
Other mortgages and notes payable		0.4		0.4
Total long-term debt	\$	1,586.1	\$	1,290.5

The amounts included above are net of the discount and premium associated with issuing these notes, which are being amortized to expense over the respective terms using the interest method.

On May 18, 2009, we issued \$750.0 million of senior notes. We issued a \$400.0 million series of notes that bear interest at 7.875% and will mature on May 15, 2014, and a \$350.0 million series of notes that bear interest at 8.875% and will mature on May 15, 2019. Interest on the notes is payable semi-annually on May 15 and November 15 each year, beginning on November 15, 2009. The proceeds were primarily used to refinance \$440.9 million of notes that matured on August 15, 2009, with the remaining proceeds being used for general corporate purposes.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

5. Federal Income Taxes

The effective income tax rate for the three months ended September 30, 2009, was lower than the U.S. corporate income tax rate of 35% (U.S. statutory rate) primarily due to income tax deductions allowed for corporate dividends received, taxes on our share of earnings generated from equity method investments reflected in net investment income and the interest exclusion from taxable income. The effective income tax rate for the nine months ended September 30, 2009, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the interest exclusion from taxable income and taxes on our share of earnings generated from equity method investments reflected in net investment income.

The effective income tax rate for the three months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to a third quarter 2008 adjustment to reflect a decrease in the annual estimated effective income tax rate. The change resulted from an increase in our annual estimate of net realized capital losses from the second quarter 2008 estimate. Income tax deductions allowed for corporate dividends received and taxes on our share of earnings generated from equity method investments being reflected in net investment income also contributed to a lower than U.S. statutory rate. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and additional U.S. foreign tax credits resulting from the enactment of legislation to increase the Brazilian tax rate in the second quarter of 2008. As we apply the equity method of accounting to our Brazilian operations, the net increase in deferred tax liabilities associated with the newly enacted rate is reflected in net investment income, but the benefit from additional U.S. foreign tax credits is reflected in income tax expense.

The Internal Revenue Service (IRS) is currently auditing our federal income tax returns for the years 2004 through 2007. The IRS informed us of their intent to audit our 2008 tax return beginning in early 2010. We do not expect the results of these audits or developments in other tax areas to significantly change the possible increase in the amount of unrecognized tax benefits, but the outcome of tax reviews is uncertain and unforeseen results can occur. Consistent with December 31, 2008, we estimate that it is reasonably possible that the amount of our unrecognized tax benefits could increase \$0.0 to \$11.0 million within the next twelve months.

6. Employee and Agent Benefits**Components of net periodic benefit cost (income):**

	Pension benefits		Other post-retirement benefits	
	For the three months ended September 30,		For the three months ended September 30,	
	2009	2008	2009	2008

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

	(in millions)							
Service cost	\$	12.8	\$	12.4	\$	2.8	\$	2.1
Interest cost		25.2		24.9		4.9		4.2
Expected return on plan assets		(19.9)		(32.6)		(6.5)		(9.4)
Amortization of prior service benefit		(1.9)		(1.9)		(0.5)		(0.6)
Recognized net actuarial loss (gain)		23.2		0.3		2.4		(0.8)
Net periodic benefit cost (income)	\$	39.4	\$	3.1	\$	3.1	\$	(4.5)

	Pension benefits				Other post-retirement benefits			
	For the nine months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
	(in millions)							
Service cost	\$	38.4	\$	37.2	\$	8.4	\$	6.3
Interest cost		75.6		74.6		14.7		12.6
Expected return on plan assets		(59.7)		(97.7)		(19.5)		(28.2)
Amortization of prior service benefit		(5.7)		(5.8)		(1.5)		(1.9)
Recognized net actuarial loss (gain)		69.6		0.9		7.2		(2.4)
Net periodic benefit cost (income)	\$	118.2	\$	9.2	\$	9.3	\$	(13.6)

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

6. Employee and Agent Benefits (continued)

In 2008, our return on plan assets was lower than expected, which resulted in an actuarial loss and lower plan assets at December 31, 2008. The 2008 lower than expected return caused the expected return on plan assets in 2009 to be lower and the recognition of the actuarial loss to increase as the loss is amortized.

Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act (ERISA) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2009 will be zero so we will not be required to fund our qualified pension plan during 2009. However, it is possible that we may fund the qualified and nonqualified pension plans in 2009 for a combined total of between \$31.8 million to \$100.0 million. During the three and nine months ended September 30, 2009, we contributed \$19.3 million and \$31.8 million to these plans, respectively.

7. Contingencies, Guarantees and Indemnifications

Litigation and Regulatory Contingencies

We are regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services, life, health and disability insurance. Some of the lawsuits are class actions, or purport to be, and some include claims for punitive damages. In addition, regulatory bodies, such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers. We receive requests from regulators and other governmental authorities relating to other industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life. Principal Life's Motion to Transfer Venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleged, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleged that these acts constitute prohibited transactions under ERISA. Plaintiff sought to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. On August 27, 2008, the Plaintiff's Motion for Class Certification was denied. The Plaintiff filed a petition seeking permission to appeal that ruling. The petition was denied on October 28, 2008. On May 11, 2009, Plaintiff filed a new Motion for Class Certification. Principal Life is aggressively defending the lawsuit.

On August 28, 2007, two plaintiffs, Walsh and Young, filed a putative class action lawsuit in the United States District Court for the Southern District of Iowa against Principal Life and Princor Financial Services Corporation (the Principal Defendants). The lawsuit alleges that the Principal Defendants breached alleged fiduciary duties to participants in employer-sponsored 401(k) plans who were retiring or leaving their respective plans, including providing misleading information and failing to act solely in the interests of the participants, resulting in alleged violations of ERISA. The Principal Defendants are aggressively defending the lawsuit.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

7. Contingencies, Guarantees and Indemnifications (continued)

On February 28, 2007, Luz Zapien (*Zapien*) filed a securities class action against Washington Mutual, Inc. (*WaMu*), us and certain mutual fund-related entities. The Complaint alleged that WaMu had inadequately disclosed an alleged shelf-space arrangement that misled fund investors during the putative class period. We were named in the Complaint based on our December 2006 purchase of the distributor, investment advisor and assets of the relevant WaMu mutual funds (*the acquired business*). This action was dismissed with prejudice on June 17, 2008. Plaintiff appealed the dismissal to the Ninth Circuit Court of Appeals. On March 26, 2009, the Ninth Circuit Court of Appeals granted the parties stipulation to dismiss the appeal against the Principal defendants. On August 20, 2008, counsel for the Plaintiffs filed a new class action, *Robinson v. WM Trust I, et al.*, in the United States District Court for the Western District of Washington, making the same allegations that were contained in *Zapien*. On September 26, 2008, the Robinson Plaintiffs filed a First Amended Complaint which dropped the WaMu defendants, added four directors of the Principal Mutual Funds entity in their individual capacity, and amended the putative class to include all persons or entities that purchased or otherwise acquired shares, units or like interests in any of the WM Funds (including through the reinvestment of Fund dividends) between March 1, 2002, and December 31, 2006, inclusive . A new lead plaintiff, *Dumdie* , was substituted for Robinson. On April 17, 2009, the court approved the parties' stipulated dismissal, ending the case.

On July 15, 2009, Integrative Chiropractic Center, P.C. filed a putative class action lawsuit in the United States District Court of New Jersey against us and Principal Life (together, the *Principal Defendants*). The complaint alleges the Principal Defendants systematically underpaid out of network health claims through use of a national database used to calculate the usual and customary rate. The plaintiff is also suing on behalf of a subset of purported class members who submitted claims under a group health plan subject to ERISA that was insured or administered by us, and were paid less than the amount submitted on the claim. The complaint alleges violations of ERISA, the Racketeer Influenced and Corrupt Organizations Act and the Sherman Act. The Principal Defendants have filed a Motion to Dismiss the complaint and are aggressively defending the lawsuit.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any pending litigation or regulatory matter will have a material adverse effect on our business or financial position. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could materially affect net income in a particular quarter or annual period.

Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary, joint ventures and industrial revenue bonds. These agreements generally expire through 2019. The maximum exposure under these agreements as of September 30, 2009, was approximately \$238.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material

adverse effect on our business or financial position. It is possible that performance under these guarantees could materially affect net income in a particular quarter or annual period.

We are also subject to various other indemnification obligations issued in conjunction with certain transactions, primarily the sale of Principal Residential Mortgage, Inc. and other divestitures, acquisitions and financing transactions whose terms range in duration and often are not explicitly defined. Certain portions of these indemnifications may be capped, while other portions are not subject to such limitations; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. At inception, the fair value of such indemnifications was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe that performance under these indemnifications would not result in a material adverse effect on our business or financial position. It is possible that performance under these indemnifications could materially affect net income in a particular quarter or annual period.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

8. Stockholders' Equity**Reconciliation of Outstanding Shares**

	Series A preferred stock	Series B preferred stock	Common stock
	(in millions)		
Outstanding shares at January 1, 2008	3.0	10.0	259.1
Shares issued			1.1
Treasury stock acquired			(1.0)
Outstanding shares at September 30, 2008	3.0	10.0	259.2
Outstanding shares at January 1, 2009	3.0	10.0	259.3
Shares issued			59.9
Treasury stock acquired			(0.3)
Outstanding shares at September 30, 2009	3.0	10.0	318.9

In May 2009 we issued 58.2 million shares of common stock at a price of \$19.75 per share. Net proceeds from the issuance were \$1,109.1 million. The proceeds from this offering will be used for general corporate purposes.

Comprehensive income (loss) is as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
	(in millions)			
Net income	\$ 204.2	\$ 108.7	\$ 490.8	\$ 469.4
Net change in unrealized gains (losses) on fixed maturities, available-for-sale	3,079.4	(2,001.6)	6,176.4	(4,173.6)
Net change in noncredit component of impairment losses on fixed maturities, available-for-sale	(45.3)		(162.4)	
Net change in unrealized gains (losses) on equity securities, available-for-sale	44.7	(31.3)	28.2	(33.6)
Net change in unrealized gains (losses) on equity method subsidiaries and noncontrolling interest	(39.5)	39.2	81.9	45.3

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

adjustments						
Adjustments for assumed changes in amortization patterns	(581.6)	338.8	(942.0)	632.5		
Adjustment for assumed changes in liability for policyholder benefits and claims	(57.6)	0.4	(97.7)	(11.0)		
Net change in unrealized gains (losses) on derivative instruments	18.6	16.1	(2.3)	28.0		
Change in net foreign currency translation adjustment	25.7	(60.4)	134.9	(19.9)		
Change in unrecognized post-retirement benefit obligation	23.1	(3.1)	69.1	(9.2)		
Provision for deferred income tax benefits (taxes)	(859.1)	588.0	(1,798.6)	1,234.9		
Comprehensive income (loss)	\$ 1,812.6	\$ (1,005.2)	\$ 3,978.3	\$ (1,837.2)		

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments

We use fair value measurements to record fair value of certain assets and liabilities and to estimate fair value of financial instruments not recorded at fair value but required to be disclosed at fair value. Certain financial instruments, particularly policyholder liabilities other than investment-type insurance contracts, are excluded from these fair value disclosure requirements.

Valuation hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels.

- **Level 1** Fair values are based on unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities primarily include exchange traded equity securities, mutual funds and U.S. Treasury bonds.
- **Level 2** Fair values are based on inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. Our Level 2 assets and liabilities primarily include fixed maturity securities (including public and private bonds), equity securities, over-the-counter derivatives and other investments for which public quotations are not available but that are priced by third-party pricing services or internal models using substantially all observable inputs.
- **Level 3** Fair values are based on significant unobservable inputs for the asset or liability. Our Level 3 assets and liabilities include certain fixed maturity securities, private equity securities, real estate and commercial mortgage loan investments of our separate accounts, complex derivatives and embedded derivatives that must be priced using broker quotes or other valuation methods that utilize at least one significant unobservable input.

Determination of fair value

The following discussion describes the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis or disclosed at fair value. The techniques utilized in estimating the fair values of financial instruments are reliant on the assumptions used. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during 2009.

Fixed Maturities and Equity Securities

In determining fair value for fixed maturities, our first priority is to obtain prices from third party pricing vendors. We have regular interaction with these vendors to ensure we understand their pricing methodologies and to confirm that they are utilizing observable market information. Their methodologies vary by asset class and include inputs such as estimated cash flows, benchmark yields, reported trades, broker quotes, credit quality, industry events and economic events. If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to corporate bonds, as described below, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available. As of September 30, 2009, less than 2% of our fixed maturity securities, which were classified as Level 3 assets, were valued using internal pricing models.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)

For corporate bonds where quoted market prices are not available, a matrix pricing valuation approach is used. In this approach, securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors.

Fair values of equity securities are determined using public quotations, when available. When public quotations are not available, we may utilize internal valuation methodologies appropriate for the specific asset. Fair values might also be determined using broker quotes or through the use of internal models or analysis.

Mortgage Loans

Fair values of commercial and residential mortgage loans are primarily determined by discounting the expected cash flows at current treasury rates plus an applicable risk spread, which reflects credit quality and maturity of the loans. The risk spread is based on market clearing levels for loans with comparable credit quality, maturities and risk. The fair value of mortgage loans may also be based on the fair value of the underlying real estate collateral, which is estimated using appraised values.

Policy Loans

Fair values of policy loans are estimated by discounting expected cash flows using a risk-free rate based on the U.S. Treasury curve.

Derivatives

Fair values of derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The valuation models consider projected discounted cash flows, relevant swap curves and appropriate implied volatilities.

Other Investments

Other investments reported at fair value primarily include seed money investments, for which the fair value is determined using the net asset value of the fund. The carrying amounts of other assets classified as other investments in the accompanying consolidated statements of financial position approximate their fair values.

Cash and Cash Equivalents

Because of the nature of these assets, carrying amounts approximate fair values. Fair values of cash equivalents may be determined using public quotations, when available.

Separate Account Assets

Separate account assets include public equity, public and private debt securities and derivative instruments, for which fair values are determined as previously described. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of the loans. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. In addition, each property is appraised annually by an independent appraiser.

Cash Collateral and Cash Collateral Payable

The carrying amounts of cash collateral received and posted under derivative credit support annex (collateral) agreements and the carrying amount of the payable associated with our obligation to return the cash collateral received approximate their fair value.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)

Investment-Type Insurance Contracts

The fair values of our reserves and liabilities for investment-type insurance contracts are estimated using discounted cash flow analyses based on current interest rates, including non-performance risk, being offered for similar contracts with maturities consistent with those remaining for the investment-type contracts being valued. Investment-type insurance contracts include insurance, annuity and other policy contracts that do not involve significant mortality or morbidity risk and are only a portion of the policyholder liabilities appearing in the consolidated statements of financial position. Insurance contracts include insurance, annuity and other policy contracts that do involve significant mortality or morbidity risk. The fair values for our insurance contracts, other than investment-type contracts, are not required to be disclosed.

Certain annuity contracts and other investment-type insurance contracts include embedded derivatives that have been bifurcated from the host contract. The fair value of embedded derivatives is calculated based on actuarial and capital market assumptions, including non-performance risk, reflecting the projected cash flows over the life of the contract, incorporating expected policyholder behavior.

Short-Term Debt

The carrying amount of short-term debt approximates its fair value because of the relatively short time between origination of the debt instrument and its maturity.

Long-Term Debt

Fair values for debt issues are estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements.

Separate Account Liabilities

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Fair values of separate account liabilities, excluding insurance-related elements, are estimated based on market assumptions around what a potential acquirer would pay for the associated block of business, including both the separate account assets and liabilities. As the applicable separate account assets are already reflected at fair value, any adjustment to the fair value of the block is an assumed adjustment to the separate account liabilities. To compute fair value, the separate account liabilities are originally set to equal separate account assets because these are pass-through contracts. The separate account liabilities are reduced by the amount of future fees expected to be collected that are intended to offset upfront acquisition costs already incurred that a potential acquirer would not have to pay. The estimated future fees are adjusted by an adverse deviation discount and the amount is then discounted at a risk-free rate as measured by the yield on U.S. Treasury securities at maturities aligned with the estimated timing of fee collection.

Bank Deposits

The fair value of deposits of our Principal Bank subsidiary with no stated maturity, such as demand deposits, savings, and interest-bearing demand accounts, is equal to the amount payable on demand (i.e., their carrying amounts). The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Other Liabilities

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities utilizing the yield, credit quality and average maturity of each security.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)**Carrying value and estimated fair value of financial instruments**

	September 30, 2009			
	Carrying amount		Fair value	
	(in millions)			
Assets (liabilities)				
Fixed maturities, available-for-sale	\$	45,683.6	\$	45,683.6
Fixed maturities, trading		1,029.8		1,029.8
Equity securities, available-for-sale		218.4		218.4
Equity securities, trading		178.8		178.8
Mortgage loans		12,018.7		11,476.4
Policy loans		899.6		1,060.0
Other investments		519.3		519.3
Cash and cash equivalents		3,241.2		3,241.2
Derivative assets		1,448.5		1,448.5
Separate account assets		61,518.7		61,518.7
Cash collateral		366.5		366.5
Investment-type insurance contracts		(36,917.2)		(34,976.7)
Short-term debt		(107.1)		(107.1)
Long-term debt		(1,586.1)		(1,646.9)
Separate account liabilities		(56,002.9)		(54,880.0)
Derivative liabilities		(1,317.9)		(1,317.9)
Bank deposits		(2,226.2)		(2,234.1)
Cash collateral payable		(366.5)		(366.5)
Other liabilities		(105.9)		(105.9)

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)**Assets and liabilities measured at fair value on a recurring basis**

Assets and liabilities measured at fair value on a recurring basis are summarized below.

	Assets / (liabilities) measured at fair value	As of September 30, 2009		
		Fair value hierarchy level		
		Level 1	Level 2	Level 3
		(in millions)		
Assets				
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 536.0	\$ 30.3	\$ 505.7	\$
Non-U.S. governments	824.8		811.3	13.5
States and political subdivisions	1,959.8		1,959.8	
Corporate	32,609.1	108.3	31,763.3	737.5
Residential mortgage-backed securities	3,035.3		3,035.3	
Commercial mortgage-backed securities	3,737.5		3,700.9	36.6
Collateralized debt obligations	325.6		47.6	278.0
Other debt obligations	2,655.5		2,570.2	85.3
Total fixed maturities, available-for-sale	45,683.6	138.6	44,394.1	1,150.9
Fixed maturities, trading	1,029.8	227.0	739.7	63.1
Equity securities, available-for-sale	218.4	181.5	2.1	34.8
Equity securities, trading	178.8	96.7	82.1	
Derivative assets (1)	1,448.5		1,386.1	62.4
Other investments (2)	83.0	15.1	67.9	
Cash equivalents (3)	2,058.4	518.8	1,539.6	
Sub-total excluding separate account assets	50,700.5	1,177.7	48,211.6	1,311.2
Separate account assets	61,518.7	41,650.0	15,414.8	4,453.9
Total assets	\$ 112,219.2	\$ 42,827.7	\$ 63,626.4	\$ 5,765.1
Liabilities				
Investment-type insurance contracts (4)	\$ (35.0)	\$	\$	\$ (35.0)
Derivative liabilities (1)	(1,317.9)		(1,201.9)	(116.0)
Other liabilities (4)	(105.9)		(8.3)	(97.6)
Total liabilities	\$ (1,458.8)	\$	\$ (1,210.2)	\$ (248.6)
Net assets (liabilities)	\$ 110,760.4	\$ 42,827.7	\$ 62,416.2	\$ 5,516.5

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)

	Assets / (liabilities) measured at fair value	As of December 31, 2008			
		Fair value hierarchy level			
		Level 1 (in millions)	Level 2	Level 3	
Assets					
Fixed maturities, available-for-sale	\$ 40,117.2	\$ 126.7	\$ 38,817.5	\$ 1,173.0	
Fixed maturities, trading	843.4		782.7	60.7	
Equity securities, available-for-sale	242.7	176.4	10.1	56.2	
Equity securities, trading	158.0	61.3	96.7		
Derivative assets (1)	1,877.8		1,777.1	100.7	
Other investments (2)	75.9	13.2	62.7		
Cash equivalents (3)	1,807.9	656.3	1,151.6		
Sub-total excluding separate account assets	45,122.9	1,033.9	42,698.4	1,390.6	
Separate account assets	55,142.6	30,693.4	18,406.9	6,042.3	
Total assets	\$ 100,265.5	\$ 31,727.3	\$ 61,105.3	\$ 7,432.9	
Liabilities					
Investment-type insurance contracts (4)	\$ (60.2)	\$	\$	\$ (60.2)	
Derivative liabilities (1)	(2,139.1)		(1,872.2)	(266.9)	
Other liabilities (4)	(109.3)		(5.5)	(103.8)	
Total liabilities	\$ (2,308.6)	\$	\$ (1,877.7)	\$ (430.9)	
Net assets (liabilities)	\$ 97,956.9	\$ 31,727.3	\$ 59,227.6	\$ 7,002.0	

(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities.

(2) Primarily includes seed money investments reported at fair value.

(3) Includes short-term investments with a maturity date of three months or less when purchased.

(4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)**Changes in Level 3 fair value measurements**

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2009 and 2008, is as follows:

	For the three months ended September 30, 2009					Ending asset / (liability) balance as of September 30, 2009	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning asset / (liability) balance as of June 30, 2009	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements (in millions)			
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	\$ 48.0	\$ (10.5)	\$ 1.3	\$ (25.3)	\$ (51.2)	\$ 13.5	\$ (2.3)
Corporate	796.0	8.9	136.6	(152.8)		737.5	
Commercial mortgage-backed securities	34.2		4.4	(2.0)		36.6	
Collateralized debt obligations	248.1	(18.9)	51.9	(3.1)		278.0	(18.8)
Other debt obligations	117.4	(0.7)	5.9	(1.2)	(36.1)	85.3	(0.7)
Total fixed maturities, available-for-sale	1,243.7	(21.2)	200.1	(184.4)	(87.3)	1,150.9	(21.8)
Fixed maturities, trading	68.2	4.2			(9.3)	63.1	4.2
Equity securities, available-for-sale	25.1	1.4	20.8	(21.5)	9.0	34.8	
Derivative assets	67.6	(6.0)	(0.1)	0.9		62.4	(2.3)
Separate account assets	4,886.7	(383.4)		(6.3)	(43.1)	4,453.9	(393.8)
Liabilities							
Investment-type insurance contracts	(31.2)	(9.8)		6.0		(35.0)	(8.1)
Derivative liabilities	(165.5)	37.2	0.6	11.7		(116.0)	35.1
Other liabilities (2)	(32.0)		(60.9)	(4.7)		(97.6)	

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)

	For the three months ended September 30, 2008					Ending asset / (liability) balance as of September 30, 2008	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning asset / (liability) balance as of June 30, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements (in millions)			
		Included in net income (1)	Included in other comprehensive income				
Assets							
Fixed maturities, available-for-sale	\$ 1,851.5	\$ (37.0)	\$ 40.6	\$ (487.3)	\$ 79.0	\$ 1,446.8	\$ (37.3)
Fixed maturities, trading	65.4	(7.0)		3.8	9.0	71.2	(7.0)
Equity securities, available-for-sale	53.2	(10.1)	(23.3)	27.0		46.8	(10.1)
Derivative assets	77.3	6.9	(8.3)			75.9	6.9
Separate account assets	7,097.1	(84.7)		(199.4)	(1.8)	6,811.2	(101.2)
Liabilities							
Investment-type insurance contracts	(2.4)	6.0		3.4		7.0	6.1
Derivative liabilities	(113.1)	(36.5)	(2.1)	(0.1)		(151.8)	(51.6)
Other liabilities (2)	(116.9)		22.7	(4.6)		(98.8)	

	For the nine months ended September 30, 2009					Ending asset / (liability) balance as of September 30, 2009	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning asset / (liability) balance as of December 31, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements (in millions)			
		Included in net income (1)	Included in other comprehensive income				
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	\$ 45.3	\$ (10.3)	\$ 2.4	\$ (23.9)	\$ 162.4	\$ 13.5	\$ (30.4)
Corporate	750.9	(23.9)	135.1	(287.0)		737.5	
Commercial mortgage-backed securities	58.0	(0.3)	8.7	(10.6)	(19.2)	36.6	
Collateralized debt obligations	236.8	(60.2)	117.6	(8.3)	(7.9)	278.0	(59.8)
Other debt obligations	82.0	(2.1)	20.8	28.8	(44.2)	85.3	(1.6)
Total fixed maturities, available-for-sale	1,173.0	(96.8)	284.6	(301.0)	91.1	1,150.9	(91.8)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Fixed maturities, trading	60.7	12.7		(10.3)	63.1	12.7
Equity securities, available-for-sale	56.2	1.4	23.4	(55.2)	9.0	34.8
Derivative assets	100.7	(35.6)	(0.2)	(2.5)	62.4	(22.5)
Separate account assets	6,042.3	(1,377.3)		(169.6)	4,453.9	(1,278.2)
Liabilities						
Investment-type insurance contracts	(60.2)	6.3		18.9	(35.0)	6.6
Derivative liabilities	(266.9)	134.8	4.4	11.7	(116.0)	133.1
Other liabilities (2)	(103.8)		20.1	(13.9)	(97.6)	

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

9. Fair Value of Financial Instruments (continued)

	For the nine months ended September 30, 2008					Ending asset / (liability) balance as of September 30, 2008	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning asset / (liability) balance as of January 1, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements (in millions)			
		Included in net income (1)	Included in other comprehensive income				
Assets							
Fixed maturities, available-for-sale	\$ 2,201.3	\$ (87.4)	\$ (321.6)	\$ (562.1)	\$ 216.6	\$ 1,446.8	\$ (53.5)
Fixed maturities, trading	92.3	(8.6)		(11.4)	(1.1)	71.2	(8.6)
Equity securities, available-for-sale	51.1	(44.4)	(23.1)	25.2	38.0	46.8	(44.9)
Derivative assets	54.3	24.1	(2.5)			75.9	26.0
Separate account assets	7,313.2	(368.5)		(59.3)	(74.2)	6,811.2	(371.9)
Liabilities							
Investment-type insurance contracts	(49.3)	13.3		43.0		7.0	13.5
Derivative liabilities	(62.3)	(89.6)	(0.9)	1.0		(151.8)	(93.2)
Other liabilities (2)	(155.6)		70.7	(13.9)		(98.8)	

(1) Both realized gains (losses) and mark-to-market unrealized gains (losses) are generally reported in net realized capital gains (losses) within the consolidated statements of operations. Gains and losses for separate account assets do not impact net income as the change in value of separate account assets is offset by a change in value of separate account liabilities.

(2) Certain embedded derivatives reported in other liabilities are part of a cash flow hedge, with the effective portion of the unrealized gains (losses) recorded in accumulated OCI.

Assets and liabilities measured at fair value on a nonrecurring basis

Certain assets are measured at fair value on a nonrecurring basis. As of September 30, 2009, mortgage loans with an aggregate cost of \$11.9 million had been written down to fair value of \$4.7 million. This write down resulted in a loss of \$0.1 million and \$7.2 million for the three and nine months ended September 30, 2009, respectively, that was recorded in net realized capital gains (losses). These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values.

As of September 30, 2009, real estate with an aggregate cost of \$1.7 million had been written down to fair value of \$0.9 million. This write down resulted in a loss of \$0.4 million and \$0.8 million for the three and nine months ended September 30, 2009, respectively, that was recorded in net realized capital gains (losses). This is a Level 3 fair value measurement, as the fair value of the real estate is estimated using appraised values that involve significant unobservable inputs.

As of September 30, 2008, mortgage servicing rights with an aggregate cost of \$9.0 million had been written down to fair value of \$7.9 million resulting in a charge of zero and \$1.1 million for the three and nine months ended September 30, 2008, respectively, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans.

Transition

In connection with our adoption of fair value measurement guidance on January 1, 2008, we recorded a \$13.0 million pre-tax gain in net realized capital gains (losses) resulting from the incorporation of our own creditworthiness and additional risk margins in the valuation of certain embedded derivatives recorded at fair value.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

10. Segment Information

We provide financial products and services through the following segments: U.S. Asset Accumulation, Global Asset Management, International Asset Management and Accumulation and Life and Health Insurance. In addition, there is a Corporate segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

The U.S. Asset Accumulation segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals.

The Global Asset Management segment provides asset management services to our asset accumulation business, our life and health insurance operations, the Corporate segment and third-party clients.

The International Asset Management and Accumulation segment consists of Principal International, which has operations in Brazil, Chile, China, Hong Kong Special Administrative Region, India, Indonesia, Malaysia, Mexico and Singapore. We focus on countries with large middle classes, favorable demographics and growing long-term savings with defined contribution markets. We entered these countries through acquisitions, start-up operations and joint ventures.

The Life and Health insurance segment provides individual life insurance, group health insurance and specialty benefits, which consists of group dental and vision insurance, individual and group disability insurance and group life insurance, throughout the United States.

The Corporate segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate segment primarily reflect our financing activities (including interest expense), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

Management uses segment operating earnings in goal setting, as a basis for determining employee compensation and in evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income for net realized capital gains (losses), as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized capital gains (losses), as adjusted, are net of income taxes, related changes in the amortization pattern of DPAC and sales inducements, recognition of deferred front-end fee revenues for sales charges on retirement products and services, net realized capital gains and losses distributed, noncontrolling interest capital gains and losses and certain market value adjustments to fee revenues. Net realized capital

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

gains (losses), as adjusted, exclude periodic settlements and accruals on non-hedge derivative instruments and exclude certain market value adjustments of embedded derivatives. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on non-hedge derivatives), including their impact on recognition of front-end fee revenues and certain market value adjustments to fee revenues and revenue from our terminated commercial mortgage securities issuance operation. Segment operating revenues include operating revenues from real estate properties that qualify for discontinued operations. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

The accounting policies of the segments are consistent with the accounting policies for the consolidated financial statements, with the exception of income tax allocation. The Corporate segment functions to absorb the risk inherent in interpreting and applying tax law. The segments are allocated tax adjustments consistent with the positions we took on tax returns. The Corporate segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

10. Segment Information (continued)

The following tables summarize selected financial information by segment and reconcile segment totals to those reported in the consolidated financial statements:

	September 30, 2009		December 31, 2008	
	(in millions)			
Assets:				
U.S. Asset Accumulation	\$	107,507.8	\$	100,468.8
Global Asset Management		1,225.3		1,320.6
International Asset Management and Accumulation		9,547.9		7,878.4
Life and Health Insurance		15,395.0		14,526.2
Corporate		3,703.5		3,988.4
Total consolidated assets	\$	137,379.5	\$	128,182.4

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
	(in millions)							
Operating revenues by segment:								
U.S. Asset Accumulation	\$	1,025.6	\$	1,237.5	\$	3,024.4	\$	3,697.9
Global Asset Management		111.3		141.7		319.0		425.0
International Asset Management and Accumulation		156.1		265.5		381.8		700.4
Life and Health Insurance		1,104.2		1,158.9		3,352.1		3,527.1
Corporate		(40.1)		(52.4)		(123.2)		(152.3)
Total segment operating revenues		2,357.1		2,751.2		6,954.1		8,198.1
Net realized capital losses (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues		(86.2)		(248.3)		(336.7)		(517.5)
Terminated commercial mortgage securities issuance operation		(0.6)		(5.1)		(0.7)		(24.0)
Total revenues per consolidated statements of operations	\$	2,270.3	\$	2,497.8	\$	6,616.7	\$	7,656.6
Operating earnings (losses) by segment, net of related income taxes:								
U.S. Asset Accumulation	\$	154.6	\$	136.5	\$	385.1	\$	428.5
Global Asset Management		10.5		23.5		25.5		67.4
International Asset Management and Accumulation		33.1		44.4		79.4		107.9
Life and Health Insurance		68.2		73.9		197.7		219.8
Corporate		(27.7)		(27.1)		(84.5)		(59.9)
Total segment operating earnings, net of related income taxes		238.7		251.2		603.2		763.7

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net realized capital losses, as adjusted (1)		(53.5)		(156.3)		(154.6)		(316.4)
Other after-tax adjustments (2)		(0.5)		(4.8)		(0.8)		(14.7)
Net income available to common stockholders per consolidated statements of operations	\$	184.7	\$	90.1	\$	447.8	\$	432.6

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

10. Segment Information (continued)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

(1) Net realized capital losses, as adjusted, is derived as follows:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
(in millions)								
Net realized capital losses	\$	(66.6)	\$	(230.6)	\$	(285.1)	\$	(468.1)
Periodic settlements and accruals on non-hedge derivatives		(20.3)		(17.6)		(48.0)		(45.8)
Certain market value adjustments to fee revenues				(0.1)		(1.5)		(3.6)
Recognition of front-end fee revenues		0.7				(2.1)		
Net realized capital losses, net of related revenue adjustments		(86.2)		(248.3)		(336.7)		(517.5)
Amortization of deferred policy acquisition and sales inducement costs		16.7		16.2		106.3		46.1
Capital (gains) losses distributed		(7.5)		11.8		(14.4)		14.2
Certain market value adjustments of embedded derivatives		2.3		(3.3)		8.8		(6.5)
Noncontrolling interest capital gains		(9.9)		(8.1)		(15.5)		(4.4)
Income tax effect		31.1		75.4		96.9		151.7
Net realized capital losses, as adjusted	\$	(53.5)	\$	(156.3)	\$	(154.6)	\$	(316.4)

(2) For the three months ended September 30, 2009, other after-tax adjustments included the negative effect of \$0.5 million resulting from losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended September 30, 2008, other after-tax adjustments included the negative effect of \$4.8 million resulting from losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the nine months ended September 30, 2009, other after-tax adjustments included the negative effect of \$0.8 million resulting from losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the nine months ended September 30, 2008, other after-tax adjustments of \$14.7 million included (1) the negative effect of losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP (\$22.3 million) and (2) the positive effect of a change in estimated loss related to a prior year legal contingency (\$7.6 million).

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

10. Segment Information (continued)

The following table summarizes operating revenues for our products and services:

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
	(in millions)			
U.S. Asset Accumulation:				
Full service accumulation	\$ 329.3	\$ 360.7	\$ 952.2	\$ 1,091.5
Principal Funds	113.1	159.3	324.0	501.4
Individual annuities	247.2	278.1	713.3	769.9
Bank and trust services	22.2	18.9	61.3	55.6
Eliminations	(21.8)	(44.2)	(65.6)	(138.4)
Total Accumulation	690.0	772.8	1,985.2	2,280.0
Investment only	200.1	283.0	626.0	845.1
Full service payout	135.5	181.7	413.2	572.8
Total Guaranteed	335.6	464.7	1,039.2	1,417.9
Total U.S. Asset Accumulation	1,025.6	1,237.5	3,024.4	3,697.9
Global Asset Management (1)	111.3	141.7	319.0	425.0
International Asset Management and Accumulation	156.1	265.5	381.8	700.4
Life and Health Insurance:				
Individual life insurance	338.9	346.1	1,012.8	1,045.8
Health insurance	403.4	438.6	1,247.1	1,356.0
Specialty benefits insurance	362.5	374.8	1,093.8	1,127.0
Eliminations	(0.6)	(0.6)	(1.6)	(1.7)
Total Life and Health Insurance	1,104.2	1,158.9	3,352.1	3,527.1
Corporate	(40.1)	(52.4)	(123.2)	(152.3)
Total operating revenues	\$ 2,357.1	\$ 2,751.2	\$ 6,954.1	\$ 8,198.1
Total operating revenues	\$ 2,357.1	\$ 2,751.2	\$ 6,954.1	\$ 8,198.1
Net realized capital losses (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	(86.2)	(248.3)	(336.7)	(517.5)
Terminated commercial mortgage securities issuance operation	(0.6)	(5.1)	(0.7)	(24.0)
Total revenues per consolidated statements of operations	\$ 2,270.3	\$ 2,497.8	\$ 6,616.7	\$ 7,656.6

(1) Reflects inter-segment revenues of \$49.4 million and \$60.9 million and \$144.3 million and \$186.9 million for the three and nine months ended September 30, 2009 and 2008, respectively. These revenues are eliminated within the Corporate segment.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

11. Stock-Based Compensation Plans

As of September 30, 2009, we have the 2005 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan, the Directors Stock Plan and the Long-Term Performance Plan (Stock-Based Compensation Plans). As of May 17, 2005, no new grants will be made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan.

As of September 30, 2009, the maximum number of new shares of common stock that were available for grant under the 2005 Stock Incentive Plan and the 2005 Directors Stock Plan was 13.5 million.

The compensation cost that was charged against income for stock-based awards granted under the Stock-Based Compensation Plans is as follows:

	For the nine months ended September 30,			
	2009		2008	
	(in millions)			
Compensation cost	\$	37.6	\$	33.0
Related income tax benefit		12.2		10.6
Capitalized as part of an asset		2.8		3.7

Nonqualified Stock Options

Nonqualified stock options were granted to certain employees under the 2005 Stock Incentive Plan. Total options granted were 2.2 million for the nine months ended September 30, 2009. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 4.1 percent, a weighted-average expected volatility of 55.0 percent, a weighted-average risk-free interest rate of 2.1 percent and a weighted-average expected term of 6 years. The weighted-average estimated fair value of stock options granted during the nine months ended September 30, 2009, was \$4.07 per share.

As of September 30, 2009, there were \$8.4 million of total unrecognized compensation costs related to nonvested stock options. The costs are expected to be recognized over a weighted-average service period of approximately 1.5 years.

Performance Share Awards

Performance share awards were granted to certain employees under the 2005 Stock Incentive Plan. Total performance share awards granted were 0.5 million for the nine months ended September 30, 2009. The performance share awards granted represent initial target awards and do not reflect potential decreases resulting from the final performance objective to be determined at the end of the performance period. The actual number of shares to be awarded at the end of each performance period will be either 0% or 100% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was \$11.07 per common share.

As of September 30, 2009, there were \$2.8 million of total unrecognized compensation costs related to nonvested performance share awards granted. The costs are expected to be recognized over a weighted-average service period of approximately 1.9 years.

Restricted Stock Units

Restricted stock units were issued to certain employees and agents pursuant to the 2005 Stock Incentive Plan. Total restricted stock units granted were 1.8 million for the nine months ended September 30, 2009. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was \$11.53 per common share.

As of September 30, 2009, there were \$26.6 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted. The costs are expected to be recognized over a weighted-average period of approximately 1.7 years.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)

September 30, 2009

(Unaudited)

11. Stock-Based Compensation Plans (continued)**Employee Stock Purchase Plan**

As of January 1, 2009, the offering period for the Employee Stock Purchase Plan changed from three to six months. Under the Employee Stock Purchase Plan, employees purchased 0.6 million shares for the nine months ended September 30, 2009. The weighted-average fair value of the discount on the stock purchased was \$2.83 per share.

As of September 30, 2009, a total of 9.0 million of new shares are available to be made issuable by us for this plan.

12. Earnings Per Common Share

The computations of the basic and diluted per share amounts were as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
	(in millions, except per share data)			
Net income	\$ 204.2	\$ 108.7	\$ 490.8	\$ 469.4
Subtract:				
Net income attributable to noncontrolling interest	11.3	10.4	18.3	12.1
Preferred stock dividends	8.2	8.2	24.7	24.7
Net income available to common stockholders	\$ 184.7	\$ 90.1	\$ 447.8	\$ 432.6
Weighted-average shares outstanding				
Basic	319.1	259.5	289.9	259.2
Dilutive effects:				
Stock options	0.9	1.1	0.3	1.6
Restricted stock units	1.5	0.3	0.9	0.4
Performance share awards		0.1		0.1
Diluted	321.5	261.0	291.1	261.3
Net income per common share:				
Basic	\$ 0.58	\$ 0.35	\$ 1.54	\$ 1.67
Diluted	\$ 0.57	\$ 0.35	\$ 1.54	\$ 1.66

The calculation of diluted earnings per share for the three and nine months ended September 30, 2009 and 2008, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)

September 30, 2009

(Unaudited)

13. Condensed Consolidating Financial Information

Principal Life has established special purpose entities to issue secured medium-term notes. Under the program, the payment obligations of principal and interest on the notes are secured by funding agreements issued by Principal Life. Principal Life's payment obligations on the funding agreements are fully and unconditionally guaranteed by PFG. All of the outstanding stock of Principal Life is indirectly owned by PFG and PFG is the only guarantor of the payment obligations of the funding agreements.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) Principal Life, (iii) Principal Financial Services, Inc. (PFS) and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2009 and December 31, 2008, and for the nine months ended September 30, 2009 and 2008.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in PFS, (ii) Principal Life's interest in all direct subsidiaries of Principal Life and (iii) PFS's interest in Principal Life even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent's investment and earnings. All intercompany balances and transactions, including elimination of the parent's investment in subsidiaries, between PFG, Principal Life and PFS and all other subsidiaries have been eliminated, as shown in the column Eliminations and Other. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
September 30, 2009

	Principal Financial Group, Inc. Parent Only		Principal Life Insurance Company Only		Principal Financial Services, Inc. and Other Subsidiaries Combined		Eliminations and Other		Principal Financial Group, Inc. Consolidated	
	(in millions)									
Assets										
Fixed maturities, available-for-sale	\$	104.7	\$	40,574.2	\$	5,607.2	\$	(602.5)	\$	45,683.6
Fixed maturities, trading		345.7		486.4		197.7				1,029.8
Equity securities, available-for-sale				216.2		2.2				218.4
Equity securities, trading				0.4		178.4				178.8
Mortgage loans				10,114.8		2,383.7		(479.8)		12,018.7
Real estate				19.6		1,007.6		(2.3)		1,024.9
Policy loans				880.6		19.0				899.6
Investment in unconsolidated entities		7,652.8		3,201.3		2,507.1		(12,802.6)		558.6
Other investments		5.3		1,899.6		631.2		(541.5)		1,994.6
Cash and cash equivalents		880.6		1,632.8		1,009.5		(281.7)		3,241.2
Accrued investment income		1.2		686.4		62.3		(7.2)		742.7
Premiums due and other receivables				925.0		208.7		2.1		1,135.8
Deferred policy acquisition costs				3,378.7		212.7				3,591.4
Property and equipment				426.7		70.1				496.8
Goodwill				96.7		285.9				382.6
Other intangibles				34.2		830.7				864.9
Separate account assets				56,515.1		5,003.6				61,518.7
Other assets		12.6		662.9		560.4		562.5		1,798.4
Total assets	\$	9,002.9	\$	121,751.6	\$	20,778.0	\$	(14,153.0)	\$	137,379.5
Liabilities										
Contractholder funds	\$		\$	41,165.7	\$	30.9	\$	(244.9)	\$	40,951.7
Future policy benefits and claims				15,907.6		3,048.1		(17.7)		18,938.0
Other policyholder funds				546.0		18.4				564.4
Short-term debt						139.1		(32.0)		107.1

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Long-term debt	1,351.8	99.5	882.4	(747.6)	1,586.1
Income taxes currently payable	(18.4)	(217.2)	17.3	220.3	2.0
Deferred income taxes	(26.0)	(662.3)	253.0	551.4	116.1
Separate account liabilities		56,515.1	5,003.6		61,518.7
Other liabilities	88.8	2,708.1	3,732.4	(540.6)	5,988.7
Total liabilities	1,396.2	116,062.5	13,125.2	(811.1)	129,772.8
Stockholders' equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	4.5	2.5		(2.5)	4.5
Additional paid-in capital	9,480.7	6,098.5	8,274.7	(14,373.2)	9,480.7
Retained earnings	4,180.2	911.0	668.9	(1,579.9)	4,180.2
Accumulated other comprehensive loss	(1,434.1)	(1,416.2)	(1,388.8)	2,805.0	(1,434.1)
Treasury stock, at cost	(4,722.7)				(4,722.7)
Total stockholders' equity attributable to PFG	7,508.7	5,595.8	7,554.8	(13,150.6)	7,508.7
Noncontrolling interest	98.0	93.3	98.0	(191.3)	98.0
Total stockholders' equity	7,606.7	5,689.1	7,652.8	(13,341.9)	7,606.7
Total liabilities and stockholders' equity	\$ 9,002.9	\$ 121,751.6	\$ 20,778.0	\$ (14,153.0)	\$ 137,379.5

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
(in millions)					
Assets					
Fixed maturities, available-for-sale	\$	\$ 36,100.6	\$ 4,509.1	\$ (492.5)	\$ 40,117.2
Fixed maturities, trading		732.3	111.1		843.4
Equity securities, available-for-sale		234.2	8.5		242.7
Equity securities, trading		0.4	157.6		158.0
Mortgage loans		10,961.8	2,586.9	(435.1)	13,113.6
Real estate		20.1	899.3		919.4
Policy loans		881.4	15.0		896.4
Investment in unconsolidated entities	3,198.5	2,903.1	(597.2)	(5,085.0)	419.4
Other investments	5.5	2,431.9	734.8	(775.0)	2,397.2
Cash and cash equivalents	(2.0)	1,598.6	1,192.3	(180.9)	2,608.0
Accrued investment income		701.3	55.2	(5.8)	750.7
Premiums due and other receivables	0.9	819.6	153.5	14.1	988.1
Deferred policy acquisition costs		3,970.1	182.9		4,153.0
Property and equipment		447.1	71.1		518.2
Goodwill		96.7	278.8		375.5
Other intangibles		35.7	889.6		925.3
Separate account assets		51,069.1	4,073.5		55,142.6
Other assets	27.0	570.6	530.9	2,485.2	3,613.7
Total assets	\$ 3,229.9	\$ 113,574.6	\$ 15,852.9	\$ (4,475.0)	\$ 128,182.4
Liabilities					
Contractholder funds	\$	\$ 43,298.3	\$ 40.2	\$ (251.9)	\$ 43,086.6
Future policy benefits and claims		15,979.0	2,526.0	(10.8)	18,494.2
Other policyholder funds		517.9	18.3		536.2
Short-term debt			500.9		500.9
Long-term debt	601.8	99.5	1,296.8	(707.6)	1,290.5
Income taxes currently payable	(9.1)	(322.5)	26.0	307.5	1.9
Deferred income taxes	(39.4)	(2,352.0)	132.2	2,362.0	102.8
Separate account liabilities		51,069.1	4,073.5		55,142.6

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Other liabilities	107.3	3,143.2	4,040.5	(833.6)	6,457.4
Total liabilities	660.6	111,432.5	12,654.4	865.6	125,613.1
Stockholders equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	3.9	2.5		(2.5)	3.9
Additional paid-in capital	8,376.5	5,626.6	7,797.7	(13,424.3)	8,376.5
Retained earnings	3,722.5	1,158.5	150.8	(1,309.3)	3,722.5
Accumulated other comprehensive loss	(4,911.6)	(4,737.6)	(4,846.7)	9,584.3	(4,911.6)
Treasury stock, at cost	(4,718.6)				(4,718.6)
Total stockholders equity attributable to PFG	2,472.8	2,050.0	3,101.8	(5,151.8)	2,472.8
Noncontrolling interest	96.5	92.1	96.7	(188.8)	96.5
Total stockholders equity	2,569.3	2,142.1	3,198.5	(5,340.6)	2,569.3
Total liabilities and stockholders equity	\$ 3,229.9	\$ 113,574.6	\$ 15,852.9	\$ (4,475.0)	\$ 128,182.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2009

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations and Other	Principal Financial Group, Inc. Consolidated
	(in millions)				
Revenues					
Premiums and other considerations	\$	\$ 2,615.1	\$ 205.4	\$	\$ 2,820.5
Fees and other revenues		999.9	763.4	(223.9)	1,539.4
Net investment income	1.4	2,251.9	263.8	24.8	2,541.9
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	1.0	(316.1)	447.1	(69.5)	62.5
Total other-than-temporary impairment losses on available-for-sale securities		(507.7)	(2.3)		(510.0)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income		161.2	1.2		162.4
Net impairment losses on available-for-sale securities		(346.5)	(1.1)		(347.6)
Net realized capital gains (losses)	1.0	(662.6)	446.0	(69.5)	(285.1)
Total revenues	2.4	5,204.3	1,678.6	(268.6)	6,616.7
Expenses					
Benefits, claims and settlement expenses		3,741.1	229.3	(12.4)	3,958.0
Dividends to policyholders		188.3			188.3
Operating expenses	61.3	1,256.5	758.9	(182.6)	1,894.1
Total expenses	61.3	5,185.9	988.2	(195.0)	6,040.4
Income (loss) before income taxes	(58.9)	18.4	690.4	(73.6)	576.3
Income taxes (benefits)	(23.2)	(41.8)	149.7	0.8	85.5
	526.5	345.7	(14.2)	(858.0)	

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Equity in the net income (loss) of subsidiaries										
Net income		490.8		405.9		526.5		(932.4)		490.8
Net income attributable to noncontrolling interest		18.3		18.3		18.3		(36.6)		18.3
Net income attributable to PFG		472.5		387.6		508.2		(895.8)		472.5
Preferred stock dividends		24.7								24.7
Net income available to common stockholders	\$	447.8	\$	387.6	\$	508.2	\$	(895.8)	\$	447.8

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
(in millions)					
Revenues					
Premiums and other considerations	\$	\$ 3,050.9	\$ 208.0	\$	\$ 3,258.9
Fees and other revenues		1,109.8	1,059.0	(333.9)	1,834.9
Net investment income (loss)	(0.2)	2,447.7	571.5	11.9	3,030.9
Net realized capital losses, excluding impairment losses on available-for-sale securities	(1.2)	(145.5)	(62.1)	63.8	(145.0)
Total other-than-temporary impairment losses on available-for-sale securities		(322.2)	(0.9)		(323.1)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income					
Net impairment losses on available-for-sale securities		(322.2)	(0.9)		(323.1)
Net realized capital losses	(1.2)	(467.7)	(63.0)	63.8	(468.1)
Total revenues	(1.4)	6,140.7	1,775.5	(258.2)	7,656.6
Expenses					
Benefits, claims and settlement expenses		4,216.2	499.0	(12.0)	4,703.2
Dividends to policyholders		210.2			210.2
Operating expenses	35.8	1,491.1	979.3	(289.2)	2,217.0
Total expenses	35.8	5,917.5	1,478.3	(301.2)	7,130.4
Income (loss) before income taxes	(37.2)	223.2	297.2	43.0	526.2
Income taxes (benefits)	(15.5)	25.7	49.2	(2.6)	56.8
Equity in the net income of subsidiaries	491.1	205.3	243.1	(939.5)	
Net income	469.4	402.8	491.1	(893.9)	469.4
Net income attributable to noncontrolling interest	12.1	13.0	12.1	(25.1)	12.1

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net income attributable to PFG		457.3		389.8		479.0		(868.8)		457.3
Preferred stock dividends		24.7								24.7
Net income available to common stockholders	\$	432.6	\$	389.8	\$	479.0	\$	(868.8)	\$	432.6

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2009

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations and Other	Principal Financial Group, Inc. Consolidated
(in millions)					
Operating activities					
Net cash provided by (used in) operating activities	\$ (403.3)	\$ 2,052.1	\$ 162.4	\$ (16.8)	\$ 1,794.4
Investing activities					
Available-for-sale securities:					
Purchases	(691.5)	(4,995.6)	(992.6)	79.0	(6,600.7)
Sales	634.0	2,813.2	323.9	(0.6)	3,770.5
Maturities		2,812.3	333.7		3,146.0
Mortgage loans acquired or originated		(269.4)	(70.5)	68.1	(271.8)
Mortgage loans sold or repaid		1,056.5	247.5	(56.8)	1,247.2
Real estate acquired			(50.2)		(50.2)
Real estate sold			22.1		22.1
Net purchases of property and equipment		(7.8)	(12.8)		(20.6)
Purchases of interests in subsidiaries, net of cash acquired			(45.7)		(45.7)
Dividends received from (contributions to) unconsolidated entities	(496.0)	38.6	149.0	308.4	
Net change in other investments	0.1	57.1	3.9	(101.7)	(40.6)
Net cash provided by (used in) investing activities	(553.4)	1,504.9	(91.7)	296.4	1,156.2
Financing activities					
Issuance of common stock	1,123.0				1,123.0
Acquisition of treasury stock	(4.1)				(4.1)
Proceeds from financing element derivatives		121.3			121.3
Payments for financing element derivatives		(57.7)			(57.7)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Excess tax benefits from share-based payment arrangements					0.2				0.2
Dividends to preferred stockholders	(24.7)								(24.7)
Issuance of long-term debt	745.1				40.0	(40.0)			745.1
Principal repayments of long-term debt					(465.9)				(465.9)
Net repayments of short-term borrowings					(365.4)	(32.0)			(397.4)
Capital received from (dividends paid to) parent			(149.0)		457.4	(308.4)			
Investment contract deposits			3,438.2						3,438.2
Investment contract withdrawals			(6,871.1)						(6,871.1)
Net increase in banking operation deposits					80.2				80.2
Other			(4.5)						(4.5)
Net cash provided by (used in) financing activities	1,839.3		(3,522.8)		(253.5)	(380.4)			(2,317.4)
Net increase (decrease) in cash and cash equivalents	882.6		34.2		(182.8)	(100.8)			633.2
Cash and cash equivalents at beginning of period	(2.0)		1,598.6		1,192.3	(180.9)			2,608.0
Cash and cash equivalents at end of period	\$ 880.6	\$	1,632.8	\$	1,009.5	\$	(281.7)	\$	3,241.2

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	\$ (24.3)	\$ 1,450.3	\$ 399.1	\$ 42.1	\$ 1,867.2
Investing activities					
Available-for-sale securities:					
Purchases		(5,519.2)	(635.7)	(50.7)	(6,205.6)
Sales		356.3	168.2		524.5
Maturities		2,307.5	176.2		2,483.7
Mortgage loans acquired or originated		(1,563.6)	(206.2)	87.5	(1,682.3)
Mortgage loans sold or repaid		941.6	166.4	(66.2)	1,041.8
Real estate acquired		(0.3)	(20.3)		(20.6)
Real estate sold			68.7		68.7
Net purchases of property and equipment		(53.7)	(29.6)		(83.3)
Purchases of interests in subsidiaries, net of cash acquired			(20.3)		(20.3)
Dividends received from unconsolidated entities	6.1	104.3	7.5	(117.9)	
Net change in other investments		(139.0)	35.9	(21.8)	(124.9)
Net cash provided by (used in) investing activities	6.1	(3,566.1)	(289.2)	(169.1)	(4,018.3)
Financing activities					
Issuance of common stock	31.5				31.5
Acquisition of treasury stock	(6.4)				(6.4)
Proceeds from financing element derivatives		130.6			130.6
Payments for financing element derivatives		(91.3)			(91.3)
Excess tax benefits from share-based payment arrangements		0.7	2.1		2.8
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt			23.4	(17.0)	6.4
			(44.4)	27.1	(17.3)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Principal repayments of long-term debt					
Net proceeds of short-term borrowings			62.5	1.4	63.9
Dividends paid to parent	(7.5)		(110.4)	117.9	
Investment contract deposits	9,852.4				9,852.4
Investment contract withdrawals	(7,160.6)				(7,160.6)
Net increase in banking operation deposits			293.0		293.0
Other	(4.6)				(4.6)
Net cash provided by financing activities	0.4	2,719.7	226.2	129.4	3,075.7
Net increase (decrease) in cash and cash equivalents	(17.8)	603.9	336.1	2.4	924.6
Cash and cash equivalents at beginning of period	(3.2)	927.8	536.4	(116.6)	1,344.4
Cash and cash equivalents at end of period	\$ (21.0)	\$ 1,531.7	\$ 872.5	\$ (114.2)	\$ 2,269.0

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

On June 11, 2008, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2004, as it was scheduled to expire in the fourth quarter of 2008. Under our current shelf registration, we have the ability to issue unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration statement.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) PFS, (iii) Principal Life and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2009 and December 31, 2008, and for the nine months ended September 30, 2009 and 2008.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in PFS and (ii) PFS's interest in Principal Life and all other subsidiaries, where applicable, even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent's investment and earnings. All intercompany balances and transactions, including elimination of the parent's investment in subsidiaries, between PFG, PFS and Principal Life and all other subsidiaries have been eliminated, as shown in the column Eliminations and Other. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
September 30, 2009

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations and Other	Principal Financial Group, Inc. Consolidated
	(in millions)				
Assets					
Fixed maturities, available-for-sale	\$ 104.7	\$	\$ 45,578.9	\$	\$ 45,683.6
Fixed maturities, trading	345.7		684.1		1,029.8
Equity securities, available-for-sale			218.4		218.4
Equity securities, trading			178.8		178.8
Mortgage loans			12,018.7		12,018.7
Real estate			1,024.9		1,024.9
Policy loans			899.6		899.6
Investment in unconsolidated entities	7,652.8	7,726.8	558.3	(15,379.3)	558.6
Other investments	5.3	49.8	1,939.5		1,994.6
Cash and cash equivalents	880.6	422.0	2,698.5	(759.9)	3,241.2
Accrued investment income	1.2		741.5		742.7
Premiums due and other receivables			1,135.2	0.6	1,135.8
Deferred policy acquisition costs			3,591.4		3,591.4
Property and equipment			496.8		496.8
Goodwill			382.6		382.6
Other intangibles			864.9		864.9
Separate account assets			61,518.7		61,518.7
Other assets	12.6	9.1	1,757.7	19.0	1,798.4
Total assets	\$ 9,002.9	\$ 8,207.7	\$ 136,288.5	\$ (16,119.6)	\$ 137,379.5

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position (continued)
September 30, 2009

	Principal Financial Group, Inc. Parent Only		Principal Financial Services, Inc. Only		Principal Life Insurance Company and Other Subsidiaries Combined		Eliminations and Other		Principal Financial Group, Inc. Consolidated	
	(in millions)									
Liabilities										
Contractholder funds	\$		\$		\$	40,951.7	\$		\$	40,951.7
Future policy benefits and claims						18,938.0				18,938.0
Other policyholder funds						564.4				564.4
Short-term debt				87.0		339.9		(319.8)		107.1
Long-term debt		1,351.8				234.3				1,586.1
Income taxes currently payable		(18.4)		(6.8)		11.8		15.4		2.0
Deferred income taxes		(26.0)		(7.1)		142.9		6.3		116.1
Separate account liabilities						61,518.7				61,518.7
Other liabilities		88.8		481.8		5,860.0		(441.9)		5,988.7
Total liabilities		1,396.2		554.9		128,561.7		(740.0)		129,772.8
Stockholders' equity										
Series A preferred stock										
Series B preferred stock		0.1								0.1
Common stock		4.5				17.8		(17.8)		4.5
Additional paid-in capital		9,480.7		8,274.7		7,661.7		(15,936.4)		9,480.7
Retained earnings		4,180.2		668.9		1,327.9		(1,996.8)		4,180.2
Accumulated other comprehensive loss		(1,434.1)		(1,388.8)		(1,376.7)		2,765.5		(1,434.1)
Treasury stock, at cost		(4,722.7)				(2.0)		2.0		(4,722.7)
Total stockholders' equity attributable to PFG		7,508.7		7,554.8		7,628.7		(15,183.5)		7,508.7
Noncontrolling interest		98.0		98.0		98.1		(196.1)		98.0
Total stockholders' equity		7,606.7		7,652.8		7,726.8		(15,379.6)		7,606.7
Total liabilities and stockholders' equity	\$	9,002.9	\$	8,207.7	\$	136,288.5	\$	(16,119.6)	\$	137,379.5

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations and Other	Principal Financial Group, Inc. Consolidated
(in millions)					
Assets					
Fixed maturities, available-for-sale	\$	\$	\$ 40,117.2	\$	\$ 40,117.2
Fixed maturities, trading			843.4		843.4
Equity securities, available-for-sale			242.7		242.7
Equity securities, trading			158.0		158.0
Mortgage loans			13,113.6		13,113.6
Real estate			919.4		919.4
Policy loans			896.4		896.4
Investment in unconsolidated entities	3,198.5	3,942.4	419.2	(7,140.7)	419.4
Other investments	5.5	129.5	2,340.1	(77.9)	2,397.2
Cash and cash equivalents	(2.0)	546.0	2,728.5	(664.5)	2,608.0
Accrued investment income			750.7		750.7
Premiums due and other receivables	0.9	6.7	980.8	(0.3)	988.1
Deferred policy acquisition costs			4,153.0		4,153.0
Property and equipment			518.2		518.2
Goodwill			375.5		375.5
Other intangibles			925.3		925.3
Separate account assets			55,142.6		55,142.6
Other assets	27.0	64.4	3,506.2	16.1	3,613.7
Total assets	\$ 3,229.9	\$ 4,689.0	\$ 128,130.8	\$ (7,867.3)	\$ 128,182.4
Liabilities					
Contractholder funds	\$	\$	\$ 43,086.6	\$	\$ 43,086.6
Future policy benefits and claims			18,494.2		18,494.2
Other policyholder funds			536.2		536.2
Short-term debt		482.3	309.8	(291.2)	500.9
Long-term debt	601.8	454.9	233.8		1,290.5
Income taxes currently payable	(9.1)	(7.0)	12.1	5.9	1.9
Deferred income taxes	(39.4)	(10.5)	126.9	25.8	102.8
Separate account liabilities			55,142.6		55,142.6
Other liabilities	107.3	570.8	6,246.2	(466.9)	6,457.4

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Total liabilities	660.6	1,490.5	124,188.4	(726.4)	125,613.1
Stockholders equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	3.9		17.8	(17.8)	3.9
Additional paid-in capital	8,376.5	7,797.7	7,178.2	(14,975.9)	8,376.5
Retained earnings	3,722.5	150.8	1,494.4	(1,645.2)	3,722.5
Accumulated other comprehensive loss	(4,911.6)	(4,846.7)	(4,842.7)	9,689.4	(4,911.6)
Treasury stock, at cost	(4,718.6)		(2.0)	2.0	(4,718.6)
Total stockholders equity attributable to PFG	2,472.8	3,101.8	3,845.7	(6,947.5)	2,472.8
Noncontrolling interest	96.5	96.7	96.7	(193.4)	96.5
Total stockholders equity	2,569.3	3,198.5	3,942.4	(7,140.9)	2,569.3
Total liabilities and stockholders equity	\$ 3,229.9	\$ 4,689.0	\$ 128,130.8	\$ (7,867.3)	\$ 128,182.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2009

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations and Other	Principal Financial Group, Inc. Consolidated
	(in millions)				
Revenues					
Premiums and other considerations	\$	\$	\$ 2,820.5	\$	\$ 2,820.5
Fees and other revenues		0.1	1,549.0	(9.7)	1,539.4
Net investment income (loss)	1.4	(0.2)	2,540.4	0.3	2,541.9
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	1.0	(0.4)	61.9		62.5
Total other-than-temporary impairment losses on available-for-sale securities			(510.0)		(510.0)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income			162.4		162.4
Net impairment losses on available-for-sale securities			(347.6)		(347.6)
Net realized capital gains (losses)	1.0	(0.4)	(285.7)		(285.1)
Total revenues	2.4	(0.5)	6,624.2	(9.4)	6,616.7
Expenses					
Benefits, claims and settlement expenses			3,958.0		3,958.0
Dividends to policyholders			188.3		188.3
Operating expenses	61.3	27.2	1,815.0	(9.4)	1,894.1
Total expenses	61.3	27.2	5,961.3	(9.4)	6,040.4
Income (loss) before income taxes	(58.9)	(27.7)	662.9		576.3
Income taxes (benefits)	(23.2)	(17.6)	126.3		85.5
Equity in the net income of subsidiaries	526.5	536.6		(1,063.1)	
Net income	490.8	526.5	536.6	(1,063.1)	490.8
Net income attributable to noncontrolling interest	18.3	18.3	18.3	(36.6)	18.3

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net income attributable to PFG		472.5		508.2		518.3		(1,026.5)		472.5
Preferred stock dividends		24.7								24.7
Net income available to common stockholders	\$	447.8	\$	508.2	\$	518.3	\$	(1,026.5)	\$	447.8

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
(in millions)					
Revenues					
Premiums and other considerations	\$	\$	\$ 3,258.9	\$	\$ 3,258.9
Fees and other revenues		0.1	1,846.0	(11.2)	1,834.9
Net investment income (loss)	(0.2)	(2.2)	3,033.3		3,030.9
Net realized capital losses, excluding impairment losses on available-for-sale securities	(1.2)	(0.4)	(143.3)	(0.1)	(145.0)
Total other-than-temporary impairment losses on available-for-sale securities			(323.1)		(323.1)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income					
Net impairment losses on available-for-sale securities			(323.1)		(323.1)
Net realized capital losses	(1.2)	(0.4)	(466.4)	(0.1)	(468.1)
Total revenues	(1.4)	(2.5)	7,671.8	(11.3)	7,656.6
Expenses					
Benefits, claims and settlement expenses			4,703.2		4,703.2
Dividends to policyholders			210.2		210.2
Operating expenses	35.8	32.6	2,159.9	(11.3)	2,217.0
Total expenses	35.8	32.6	7,073.3	(11.3)	7,130.4
Income (loss) before income taxes	(37.2)	(35.1)	598.5		526.2
Income taxes (benefits)	(15.5)	(29.7)	102.0		56.8
Equity in the net income of subsidiaries	491.1	496.5		(987.6)	
Net income	469.4	491.1	496.5	(987.6)	469.4
Net income attributable to noncontrolling interest	12.1	12.1	11.8	(23.9)	12.1

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net income attributable to PFG		457.3		479.0		484.7		(963.7)		457.3
Preferred stock dividends		24.7								24.7
Net income available to common stockholders	\$	432.6	\$	479.0	\$	484.7	\$	(963.7)	\$	432.6

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2009

	Principal Financial Group, Inc. Parent Only		Principal Financial Services, Inc. Only		Principal Life Insurance Company and Other Subsidiaries Combined		Eliminations and Other		Principal Financial Group, Inc. Consolidated	
	(in millions)									
Operating activities										
Net cash provided by (used in) operating activities	\$	(403.3)	\$	87.0	\$	2,141.7	\$	(31.0)	\$	1,794.4
Investing activities										
Available-for-sale securities:										
Purchases		(691.5)		(50.0)		(5,859.2)				(6,600.7)
Sales		634.0				3,136.5				3,770.5
Maturities						3,146.0				3,146.0
Mortgage loans acquired or originated						(271.8)				(271.8)
Mortgage loans sold or repaid						1,247.2				1,247.2
Real estate acquired						(50.2)				(50.2)
Real estate sold						22.1				22.1
Net purchases of property and equipment						(20.6)				(20.6)
Purchases of interests in subsidiaries, net of cash acquired						(45.7)				(45.7)
Dividends received from (contributions to) unconsolidated entities		(496.0)		156.3				339.7		
Net change in other investments		0.1		37.3		(42.2)		(35.8)		(40.6)
Net cash provided by (used in) investing activities		(553.4)		143.6		1,262.1		303.9		1,156.2
Financing activities										
Issuance of common stock		1,123.0								1,123.0
Acquisition of treasury stock		(4.1)								(4.1)
Proceeds from financing element derivatives						121.3				121.3
Payments for financing element derivatives						(57.7)				(57.7)
Excess tax benefits from share-based payment arrangements						0.2				0.2

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Dividends to preferred stockholders		(24.7)							(24.7)	
Issuance of long-term debt		745.1							745.1	
Principal repayments of long-term debt			(454.6)		(11.3)				(465.9)	
Net proceeds (repayments) of short-term borrowings			(396.0)		27.2		(28.6)		(397.4)	
Capital received from (dividends paid to) parent			496.0		(156.3)		(339.7)			
Investment contract deposits					3,438.2				3,438.2	
Investment contract withdrawals					(6,871.1)				(6,871.1)	
Net increase in banking operation deposits					80.2				80.2	
Other					(4.5)				(4.5)	
Net cash provided by (used in) financing activities		1,839.3	(354.6)		(3,433.8)		(368.3)		(2,317.4)	
Net increase (decrease) in cash and cash equivalents		882.6	(124.0)		(30.0)		(95.4)		633.2	
Cash and cash equivalents at beginning of period		(2.0)	546.0		2,728.5		(664.5)		2,608.0	
Cash and cash equivalents at end of period	\$	880.6	\$	422.0	\$	2,698.5	\$	(759.9)	\$	3,241.2

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2009
(Unaudited)

13. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only		Principal Financial Services, Inc. Only		Principal Life Insurance Company and Other Subsidiaries Combined		Eliminations		Principal Financial Group, Inc. Consolidated	
	(in millions)									
Operating activities										
Net cash provided by (used in) operating activities	\$	(24.3)	\$	10.1	\$	1,889.9	\$	(8.5)	\$	1,867.2
Investing activities										
Available-for-sale securities:										
Purchases					(6,205.6)				(6,205.6)	
Sales					524.5				524.5	
Maturities					2,483.7				2,483.7	
Mortgage loans acquired or originated					(1,682.3)				(1,682.3)	
Mortgage loans sold or repaid					1,041.8				1,041.8	
Real estate acquired					(20.6)				(20.6)	
Real estate sold					68.7				68.7	
Net purchases of property and equipment					(83.3)				(83.3)	
Purchases of interests in subsidiaries, net of cash acquired				(2.3)	(18.0)				(20.3)	
Dividends received from unconsolidated entities		6.1		75.1				(81.2)		
Net change in other investments				39.4	(125.4)			(38.9)		(124.9)
Net cash provided by (used in) investing activities		6.1		112.2	(4,016.5)			(120.1)		(4,018.3)
Financing activities										
Issuance of common stock		31.5								31.5
Acquisition of treasury stock		(6.4)								(6.4)
Proceeds from financing element derivatives					130.6					130.6
Payments for financing element derivatives					(91.3)					(91.3)
Excess tax benefits from share-based payment arrangements					2.8					2.8

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Dividends to preferred stockholders		(24.7)							(24.7)	
Issuance of long-term debt					6.4				6.4	
Principal repayments of long-term debt					(17.3)				(17.3)	
Net proceeds (repayments) of short-term borrowings			70.8		(59.9)		53.0		63.9	
Dividends paid to parent			(6.1)		(75.1)		81.2			
Investment contract deposits					9,852.4				9,852.4	
Investment contract withdrawals					(7,160.6)				(7,160.6)	
Net increase in banking operation deposits					293.0				293.0	
Other					(4.6)				(4.6)	
Net cash provided by financing activities		0.4	64.7		2,876.4		134.2		3,075.7	
Net increase (decrease) in cash and cash equivalents		(17.8)	187.0		749.8		5.6		924.6	
Cash and cash equivalents at beginning of period		(3.2)	349.1		1,665.1		(666.6)		1,344.4	
Cash and cash equivalents at end of period	\$	(21.0)	\$	536.1	\$	2,414.9	\$	(661.0)	\$	2,269.0

14. Subsequent Event

On October 26, 2009, our Board of Directors declared an annual common stock dividend of approximately \$159.5 million, equal to \$0.50 per share, payable on December 4, 2009, to common stockholders of record as of November 13, 2009.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of September 30, 2009, compared with December 31, 2008, and our consolidated results of operations for the three and nine months ended September 30, 2009 and 2008, prepared in conformity with U.S. GAAP. The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2008, filed with the SEC and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

Forward-Looking Information

Our narrative analysis below contains forward-looking statements intended to enhance the reader's ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as anticipate, believe, plan, estimate, expect, intend, similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties including, but not limited to, the following: (1) adverse capital and credit market conditions may significantly affect our ability to meet liquidity needs, as well as our access to capital and cost of capital; (2) a continuation of difficult conditions in the global capital markets and the economy generally may materially adversely affect our business and results of operations; (3) continued declines and volatility in the equity markets could reduce our assets under management (AUM) and may result in investors withdrawing from the markets or decreasing their rates of investment, all of which could reduce our revenues and net income; (4) there can be no assurance that actions of the U.S. government, Federal Reserve and other governmental and regulatory bodies for the purpose of stabilizing the financial markets will achieve the intended effect; (5) changes in interest rates or credit spreads may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period-to-period; (6) our investment portfolio is subject to several risks that may diminish the value of our invested assets and the investment returns credited to customers, which could reduce our sales, revenues, AUM and net income; (7) our valuation of fixed maturity and equity securities may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our results of operations or financial condition; (8) the determination of the amount of allowances and impairments taken on our investments is highly subjective and could materially impact our results of operations or financial position; (9) gross unrealized losses may be realized or result in future impairments, resulting in a reduction in our net income; (10) competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability; (11) a downgrade in our financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors, impact existing liabilities and increase our cost of capital, any of which could adversely affect our profitability and financial condition; (12) if we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced; (13) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (14) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (15) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life; (16) the pattern of amortizing our DPAC and other actuarial balances on our investment contract, participating life insurance and universal life-type products may change, impacting both the level of the asset and the timing of our net income; (17) we may need to fund deficiencies in our Closed Block assets; (18) we face risks arising from acquisitions of businesses; (19) changes in laws, regulations or accounting standards may reduce our profitability; (20) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (21) from time to time we may become subject to tax audits, tax litigation or similar proceedings, and as a result we may owe additional taxes, interest and penalties in amounts that may be material; (22) fluctuations in foreign currency exchange rates could reduce our profitability and (23) applicable laws and our stockholder rights plan, certificate of incorporation and by-laws may discourage takeovers and business combinations that our stockholders might consider in their best interests.

Table of Contents

Overview

We provide financial products and services through the following reportable segments:

- U.S. Asset Accumulation, which consists of our asset accumulation operations that provide retirement and related financial products and services. We provide a comprehensive portfolio of asset accumulation products and services to businesses and individuals in the U.S., with a concentration on small and medium-sized businesses. We offer to businesses products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, non-qualified executive benefit plans and employee stock ownership plan consulting services. We also offer annuities, mutual funds and bank products and services to the employees of our business customers and other individuals.
- Global Asset Management, which consists of our asset management operations conducted through Principal Global Investors and its affiliates. Global Asset Management offers an extensive range of equity, fixed income and real estate investments as well as specialized overlay and advisory services to institutional investors.
- International Asset Management and Accumulation, which consists of Principal International, offers retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products through operations in Brazil, Chile, China, Hong Kong Special Administrative Region, India, Indonesia, Malaysia, Mexico and Singapore.
- Life and Health Insurance, which provides individual life insurance, group health insurance as well as specialty benefits in the U.S. Our individual life insurance products include universal and variable universal life insurance and traditional life insurance. Our health insurance products include group medical insurance and fee-for-service claims administration and wellness services. Our specialty benefits products include group dental and vision insurance, individual and group disability insurance and group life insurance.
- Corporate, which manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate segment primarily reflect our financing activities (including interest expense), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

Recent Event

Common Stockholder Dividend

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

On October 26, 2009, our Board of Directors declared an annual common stock dividend of approximately \$159.5 million, equal to \$0.50 per share, payable on December 4, 2009, to common stockholders of record as of November 13, 2009.

Transactions Affecting Comparability of Results of Operations

Dispositions

We entered into disposition agreements or disposed of the following business during 2009 and 2008:

Post Advisory Group, LLC. Effective January 1, 2009, we sold certain fixed income asset management contracts within our Post Advisory Group, LLC subsidiary, at which time we realized benefits from the cancellation of deferred compensation agreements. The assets under management associated with this sale totaled \$3.8 billion. The total cash proceeds of \$50.0 million are expected to be received over a four year time period. The initial \$2.2 million cash down payment was received in the second quarter of 2009.

The transaction does not qualify for discontinued operations treatment under U.S. GAAP. The realized capital gain from the sale, which is reflected in our Global Asset Management segment, is not material.

Table of Contents

Other

Commercial Mortgage Securities Issuance Operation. During the third quarter of 2008, we made a decision to terminate our commercial mortgage securities issuance operation. This termination does not qualify for discontinued operations treatment under U.S. GAAP. Therefore, the results of the terminated commercial mortgage securities issuance operation are still included in our consolidated income from continuing operations.

As a result of our decision to terminate our commercial mortgage securities issuance operation, amounts previously included in our Global Asset Management segment operating earnings related to our commercial mortgage securities issuance operation have been removed from operating earnings for all periods presented and are reported as other after-tax adjustments. Our commercial mortgage securities issuance operation had operating revenues of \$(0.6) and \$(5.1) million for the three months ended September 30, 2009 and 2008, respectively, and \$(0.7) million and \$(24.0) million for the nine months ended September 30, 2009 and 2008, respectively. Our commercial mortgage securities issuance operation had after-tax operating losses of \$0.5 and \$4.8 million for the three months ended September 30, 2009 and 2008, respectively, and \$0.8 million and \$22.3 million for the nine months ended September 30, 2009 and 2008, respectively.

Fluctuations in Foreign Currency to U.S. Dollar Exchange Rates

Fluctuations in foreign currency to U.S. dollar exchange rates for countries in which we have operations can affect reported financial results. In years when foreign currencies weaken against the U.S. dollar, translating foreign currencies into U.S. dollars results in fewer U.S. dollars to be reported. When foreign currencies strengthen, translating foreign currencies into U.S. dollars results in more U.S. dollars to be reported.

Foreign currency exchange rate fluctuations create variances in our financial statement line items. Our consolidated net income was negatively impacted by \$4.9 million and positively impacted by \$5.2 million for the three months ended September 30, 2009 and 2008, respectively, and negatively impacted by \$27.0 million and positively impacted by \$11.4 million for the nine months ended September 30, 2009 and 2008, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

Stock-Based Compensation Plans

For information related to our Stock-Based Compensation Plans, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 11, Stock-Based Compensation Plans.

Defined Benefit Pension Expense

The 2009 annual pension benefit expense for substantially all of our employees and certain agents is expected to be \$157.6 million pre-tax, which is a \$145.3 million increase from the 2008 pre-tax pension expense of \$12.3 million. This increase is primarily due to lower than estimated returns on plan assets and a decrease in discount rate. Approximately \$39.4 million and \$118.2 million of pre-tax pension expense were reflected in the determination of net income for the three and nine months ended September 30, 2009, respectively. In addition, approximately \$39.4 million of pre-tax pension expense will be reflected in the fourth quarter of 2009. The discount rate used to develop the 2009 expense was 6.0%, down from the 6.3% discount rate used to develop the 2008 expense. The expected long-term return on plan assets assumption was 8.0%, down from the 8.25% used to develop the 2008 expense.

Recent Accounting Pronouncements

For recent accounting changes, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies.

Table of Contents**Results of Operations**

The following table presents summary consolidated financial information for the periods indicated:

	For the three months ended September 30,			For the nine months ended September 30,		
	2009	2008	Increase (decrease)	2009	2008	Increase (decrease)
	(in millions)					
Revenues:						
Premiums and other considerations	\$ 932.9	\$ 1,049.7	\$ (116.8)	\$ 2,820.5	\$ 3,258.9	\$ (438.4)
Fees and other revenues	550.7	599.0	(48.3)	1,539.4	1,834.9	(295.5)
Net investment income	853.3	1,079.7	(226.4)	2,541.9	3,030.9	(489.0)
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	50.6	(20.9)	71.5	62.5	(145.0)	207.5
Total other-than-temporary impairment losses on available-for-sale securities	(162.5)	(209.7)	47.2	(510.0)	(323.1)	(186.9)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income	45.3		45.3	162.4		162.4
Net impairment losses on available-for-sale securities	(117.2)	(209.7)	92.5	(347.6)	(323.1)	(24.5)
Net realized capital losses	(66.6)	(230.6)	164.0	(285.1)	(468.1)	183.0
Total revenues	2,270.3	2,497.8	(227.5)	6,616.7	7,656.6	(1,039.9)
Expenses:						
Benefits, claims and settlement expenses	1,317.1	1,597.2	(280.1)	3,958.0	4,703.2	(745.2)
Dividends to policyholders	61.9	70.4	(8.5)	188.3	210.2	(21.9)
Operating expenses	643.0	723.7	(80.7)	1,894.1	2,217.0	(322.9)
Total expenses	2,022.0	2,391.3	(369.3)	6,040.4	7,130.4	(1,090.0)
Income before income taxes	248.3	106.5	141.8	576.3	526.2	50.1
Income taxes (benefits)	44.1	(2.2)	46.3	85.5	56.8	28.7
Net income	204.2	108.7	95.5	490.8	469.4	21.4
Net income attributable to noncontrolling interest	11.3	10.4	0.9	18.3	12.1	6.2
Net income attributable to Principal Financial Group, Inc.	192.9	98.3	94.6	472.5	457.3	15.2
Preferred stock dividends	8.2	8.2		24.7	24.7	
Net income available to common stockholders	\$ 184.7	\$ 90.1	\$ 94.6	\$ 447.8	\$ 432.6	\$ 15.2

Net Income Available to Common Stockholders

Due to the challenging economic environment, our revenues have decreased while our employee pension and other post-retirement benefit costs have increased relative to 2008. In order to minimize the impact to net income available to common stockholders, we have undertaken extensive company-wide expense savings initiatives to better align our expenses with the declining revenue base.

Net income available to common stockholders increased primarily due to a \$113.8 million after-tax decrease in net realized capital losses. The change in net realized capital losses was primarily driven by lower impairments, net of noncredit losses recognized in other comprehensive income and recoveries from sales, on fixed maturity securities and mark-to-market gains versus losses on certain financial instruments and fixed maturity securities classified as trading.

Table of Contents

Total Revenues

Premiums decreased \$86.8 million for the U.S. Asset Accumulation segment, primarily due to a decrease in sales of annuities with life contingencies in our individual annuities and full service payout businesses. In addition, premiums and other considerations decreased \$51.1 million for the Life and Health Insurance segment primarily due to a reduction in average covered medical members in our health insurance business and due to the expected continued decline from our decreasing block of individual traditional life insurance business. Partially offsetting these decreases was a \$20.8 million increase for the International Asset Management and Accumulation segment primarily due to higher sales of single premium annuities with life contingencies in Chile.

Fees for the U.S. Asset Accumulation segment decreased \$35.6 million, primarily due to lower fee income stemming from a decrease in account values as a result of the declining equity markets from 2008 to 2009. In addition, fees for the Global Asset Management segment decreased \$28.4 million due to a decrease in AUM as a result of declining market conditions and the sale of certain asset management contracts within Post Advisory Group, LLC. Partially offsetting these decreases was an \$11.6 million increase for the Corporate segment primarily due to a decrease in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses.

Net investment income decreased primarily due to lower investment returns on invested assets and cash related to deflation in Chile during 2009 and our more liquid investment strategy.

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain financial instruments and our decision to sell invested assets. Net realized capital losses decreased primarily due to lower impairments, net of noncredit losses recognized in other comprehensive income and recoveries from sales, on fixed maturity securities and mark-to-market gains versus losses on certain financial instruments and fixed maturity securities classified as trading. For additional information, see Investments Investment Results.

Total Expenses

Benefits, claims and settlement expenses decreased \$169.5 million for the U.S. Asset Accumulation segment primarily due to a decrease in our investment only business resulting from our decision to scale back this business and lower variable crediting rates. Furthermore, a decrease in reserves related to lower sales of annuities with life contingencies in our full service payout and individual annuities businesses also contributed to the decrease. Benefits, claims and settlement expenses decreased \$92.1 million for the International Asset Management and Accumulation segment, primarily due to lower interest crediting rates to customers in Chile, which are impacted by deflation and the weakening of the Chilean peso against the U.S. dollar.

Operating expenses decreased \$91.7 million for the U.S. Asset Accumulation segment primarily due to a decline in DPAC amortization in our full service accumulation and individual annuities businesses, lower commission expense and fees paid to advisors due to a decline in average account values in our Principal Funds business and expense savings initiatives throughout the segment. Despite a \$43.9 million increase in employee pension and other post-retirement benefit costs, operating expenses (excluding the impacts of DPAC and commissions) for our organization have decreased as a result of company-wide expense savings initiatives.

During the third quarter of 2009, we discovered a prior period error related to DPAC amortization of certain contracts in our full service accumulation business. We evaluated the materiality of the error from qualitative and quantitative perspectives and concluded it was not material to any prior periods. The correction of the error in the current period could be considered material to the results of operations for the three months ended September 30, 2009, but is not material to the results of operations for the nine months ended September 30, 2009. Accordingly, we made an adjustment in the current period which resulted in a decrease in DPAC amortization expense. On an after-tax basis, the adjustment for prior periods resulted in an \$18.9 million increase in net income for the three months ended September 30, 2009.

Income Taxes

The effective income tax rates were 18% and (2)% for the three months ended September 30, 2009 and 2008, respectively. The effective income tax rate for the three months ended September 30, 2009, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, taxes on our share of earnings generated from equity method investments reflected in net investment income and the interest exclusion from taxable income. The

Table of Contents

effective income tax rate for the three months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to a third quarter 2008 adjustment to reflect a decrease in the annual estimated effective income tax rate resulting from an increase in our annual estimate of net realized capital losses from the second quarter 2008 estimate. Income tax deductions allowed for corporate dividends received and taxes on our share of earnings generated from equity method investments being reflected in net investment income also contributed to a lower than U.S. statutory rate. The effective income tax rate increased to 18% from (2)% for the three months ended September 30, 2009 and 2008, respectively, primarily due to a third quarter 2008 adjustment to reflect a decrease in our estimated 2008 annual effective income tax rate.

Net Income Available to Common Stockholders

Due to the challenging economic environment, our revenues have decreased while our employee pension and other post-retirement benefit costs have increased relative to 2008. In order to minimize the impact to net income available to common stockholders, we have undertaken extensive company-wide expense savings initiatives to better align our expenses with the declining revenue base.

Net income available to common stockholders increased primarily due to a \$140.0 million after-tax decrease in net realized capital losses related to mark-to-market gains versus losses on fixed maturity securities classified as trading and higher gains on sales of fixed maturity securities. Partially offsetting this increase were lower earnings in our U.S. Asset Accumulation segment primarily due to lower fee income resulting from a decrease in average account values stemming from declining equity markets from 2008 to 2009. Net income available to common stockholders also decreased for our Global Asset Management segment primarily due to the severe downturn in the global financial markets in 2008, which has led to a significant reduction in AUM and revenues. The decline in our Global Asset Management segment was offset in part by a series of expense savings initiatives, which have been undertaken in response to the market downturn.

Total Revenues

Premiums decreased \$278.6 million for the U.S. Asset Accumulation segment, primarily due to a decrease in sales of annuities with life contingencies in our full service payout and individual annuities businesses. In addition, premiums and other considerations decreased \$158.0 million for the Life and Health Insurance segment primarily due to a reduction in average covered medical members in our health insurance business and due to the expected continued decline from the decreasing block of individual traditional life insurance business.

Fees for the U.S. Asset Accumulation segment decreased \$217.6 million, primarily due to lower fee income stemming from a decrease in account values as a result of the declining equity markets from 2008 to 2009. In addition, fees for the Global Asset Management segment decreased \$100.2 million due to a decrease in AUM as a result of declining market conditions and the sale of certain asset management contracts within Post Advisory Group, LLC.

Net investment income decreased primarily due to lower investment returns on invested assets and cash related to deflation in Chile during 2009 and our more liquid investment strategy.

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain financial instruments and our decision to sell invested assets. Net realized capital losses decreased primarily due to mark-to-market gains versus losses on fixed maturity securities classified as trading and higher gains on sales of fixed maturity securities. For additional information, see [Investments](#) [Investment Results](#).

Total Expenses

Benefits, claims and settlement expenses decreased \$420.0 million for the U.S. Asset Accumulation segment primarily due to a decrease in our investment only business resulting from our decision to scale back this business and lower variable crediting rates. Furthermore, a decrease in

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

reserves related to lower sales of annuities with life contingencies in our full service payout and individual annuities businesses also contributed to the decrease. Benefits, claims and settlement expenses decreased \$269.2 million for the International Asset Management and Accumulation segment, primarily due to lower interest crediting rates to customers in Chile, which were impacted by deflation and the weakening of the Chilean peso against the U.S. dollar.

Table of Contents

Operating expenses decreased \$258.5 million for the U.S. Asset Accumulation segment primarily due to a decline in DPAC amortization in our full service accumulation and individual annuities businesses, lower commission expense and fees paid to advisors due to the decline in average account values in our Principal Funds business and expense savings initiatives throughout the segment. Despite a \$131.9 million increase in employee pension and other post-retirement benefit costs, operating expenses (excluding the impacts of DPAC and commissions) for our organization have decreased as a result of company-wide expense savings initiatives.

Income Taxes

The effective income tax rates were 15% and 11% for the nine months ended September 30, 2009 and 2008, respectively. The effective income tax rate for the nine months ended September 30, 2009, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the interest exclusion from taxable income and taxes on our share of earnings generated from equity method investments reflected in net investment income. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the interest exclusion from taxable income and additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate. The effective income tax rate increased to 15% from 11% for the nine months ended September 30, 2009 and 2008, respectively, primarily due to additional U.S. foreign tax credits reflected in 2008 as a result of the second quarter 2008 enactment of legislation to increase the Brazilian tax rate.

Results of Operations by Segment

For results of operations by segment see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Segment Information.

U.S. Asset Accumulation Segment

U.S. Asset Accumulation Segment Summary Financial Data

Account values are a key indicator of earnings growth for the segment, as account values are the asset base by which the segment generates much of its fee and spread-based revenues. Net cash flow and market performance are the two main drivers of account value growth. Net cash flow reflects the segment's ability to attract and retain client deposits. Market performance reflects not only the equity market performance, but also the investment performance of fixed income investments supporting our spread business. The percentage growth or decline in earnings of the businesses that make up this segment should closely track the percentage growth or decline in account values. This trend may vary due to changes in business and/or product mix.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Table of Contents

The following table presents the U.S. Asset Accumulation account value rollforward for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
(in billions)								
Account values, beginning of period	\$	151.1	\$	177.2	\$	146.1	\$	180.8
Net cash flow (1)		(1.1)		0.8		(0.9)		6.9
Credited investment performance		12.6		(11.1)		17.6		(19.4)
Other		(0.1)		(0.5)		(0.3)		(1.9)
Account values, end of period	\$	162.5	\$	166.4	\$	162.5	\$	166.4

(1) Includes net cash flow of \$(0.8) billion and \$(3.9) billion for the three and nine months ended September 30, 2009, respectively, resulting from the decision to scale back our investment only business.

The following table presents certain summary financial data relating to the U.S. Asset Accumulation segment for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,							
	2009		2008		2009		2008					
(in millions)												
					Increase							
					(decrease)		(decrease)					
Operating revenues:												
Premiums and other considerations	\$	59.4	\$	146.2	\$	(86.8)	\$	169.2	\$	447.8	\$	(278.6)
Fees and other revenues		330.9		366.6		(35.7)		914.4		1,134.1		(219.7)
Net investment income		635.3		724.7		(89.4)		1,940.8		2,116.0		(175.2)
Total operating revenues		1,025.6		1,237.5		(211.9)		3,024.4		3,697.9		(673.5)
Expenses:												
Benefits, claims and settlement expenses, including dividends to policyholders		540.2		702.8		(162.6)		1,667.2		2,062.9		(395.7)
Operating expenses		277.0		361.9		(84.9)		861.9		1,086.5		(224.6)
Total expenses		817.2		1,064.7		(247.5)		2,529.1		3,149.4		(620.3)
Operating earnings before income taxes		208.4		172.8		35.6		495.3		548.5		(53.2)
Income taxes		53.8		36.3		17.5		110.2		119.8		(9.6)
Operating earnings attributable to noncontrolling interest										0.2		(0.2)
Operating earnings	\$	154.6	\$	136.5	\$	18.1	\$	385.1	\$	428.5	\$	(43.4)

Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Earnings

Operating earnings increased \$20.2 million in our individual annuities business primarily due to a decrease in DPAC amortization related to favorable true-up impacts stemming from an improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of 2008. In addition, operating earnings increased \$6.1 million in our full service accumulation business primarily due to a decrease in DPAC amortization resulting from an adjustment for prior periods and from an improvement in the equity markets during the third quarter of 2009, compared to a decline in the equity markets during the third quarter of 2008. These items were partially offset by higher DPAC amortization expense due to an increase in plan termination activity due to the economic downturn. To a lesser extent, operating earnings in our full service accumulation business increased due to expense savings initiatives. The increase in our full service accumulation operating earnings was partially offset by a decrease in fee revenue stemming from a decrease in average account values. Partially offsetting the increase in segment operating earnings was a \$7.2 million decrease in our full service payout business primarily due to a decrease in spread between net investment income and interest credited to policyholders resulting from our decision to pursue a more liquid investment strategy and from a decrease in short-term investment rates.

Table of Contents

Operating Revenues

Premiums decreased \$49.5 million in our individual annuities business primarily due to a decrease in sales of annuities with life contingencies resulting from increasing competition. In addition, premiums decreased \$37.3 million in our full service payout business primarily due to a decrease in sales of single premium group annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period.

Fees decreased \$26.2 million in our full service accumulation business primarily due to lower fee income stemming from a decrease in average account values as a result of the declining equity markets from 2008 to 2009. Fees decreased \$23.2 million in our Principal Funds business primarily due to a decline in distribution income and management fee income stemming from a decrease in average account values, which resulted from a decline in the equity markets from 2008 to 2009.

Net investment income decreased primarily due to lower investment returns on invested assets and cash related to our more liquid investment strategy for the segment.

Total Expenses

Benefits, claims and settlement expenses decreased \$79.9 million in our investment only business primarily due to our decision to scale back this business and lower variable crediting rates. In addition, benefits, claims and settlement expenses decreased \$40.3 million in our individual annuities business primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies, partially offset by an increase in interest credited on a growing block of fixed annuities. Furthermore, our full service payout business recognized a \$35.5 million decrease in benefits, claims and settlement expenses due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies.

Operating expenses in our full service accumulation business decreased \$40.1 million primarily due to a decline in DPAC amortization resulting from an adjustment for prior periods and improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of 2008, which were partially offset by an increase in DPAC amortization due to an increase in plan termination activity due to the economic downturn. To a lesser extent, a decrease in expenses due to expense savings initiatives contributed to the decline in operating expenses in our full service accumulation business. In addition, operating expenses in our individual annuities business decreased \$22.8 million primarily due to a decrease in DPAC amortization related to favorable true-up impacts stemming from an improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of 2008. Furthermore, operating expenses within Principal Funds decreased \$20.9 million primarily due to lower commission expense and fees paid to advisors resulting from a decline in average account values.

Income Taxes

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The effective income tax rates for the segment were 26% and 21% for the three months ended September 30, 2009 and 2008, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily as a result of income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income. The effective income tax rate increased to 26% from 21% for the three months ended September 30, 2009 and 2008, respectively, primarily due to a third quarter 2009 adjustment to reflect an increase in our estimated 2009 annual effective income tax rate.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Earnings

Operating earnings decreased \$26.7 million and \$13.2 million in our full service accumulation and Principal Funds businesses, respectively, primarily due to lower fee income resulting from a decrease in average account values stemming from declining equity markets from 2008 to 2009. The decline in our full service accumulation business was partially offset by a decrease in DPAC amortization, which related to an adjustment for prior periods and an improvement in the equity markets during the third quarter of 2009, compared to a decline in the equity markets during the third quarter of 2008. Partially offsetting the decrease in operating earnings in our full service accumulation business was a decrease in expenses due to expense savings initiatives and lower fees paid to advisors, which resulted from a decrease in average account values. In addition, operating earnings decreased \$17.2 million and \$13.8 million in our full service payout and investment only businesses, respectively, primarily due to a decrease in spread between net investment income and interest credited to policyholders

Table of Contents

resulting from our decision to pursue a more liquid investment strategy and from a decrease in short-term investment rates. Also contributing to the decline in our investment only business was our decision to scale back this business. Partially offsetting the decrease in segment operating earnings was a \$22.7 million increase in our individual annuities business primarily due to a decrease in DPAC amortization related to favorable true-up impacts stemming from an improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of 2008.

Operating Revenues

Premiums decreased \$144.0 million in our individual annuities business primarily due to a decrease in sales of annuities with life contingencies resulting from increasing competition. In addition, premiums decreased \$134.6 million in our full service payout business primarily due to a decrease in sales of single premium group annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period.

Fees decreased \$135.5 million in our full service accumulation business primarily due to lower fee income stemming from a decrease in average account values as a result of the declining equity markets from 2008 to 2009. Fees decreased \$103.0 million in our Principal Funds business primarily due to a decline in distribution income and management fee income stemming from a decrease in average account values, which resulted from a decline in the equity markets from 2008 to 2009. Partially offsetting the decrease in segment fees was a \$33.0 million increase in our investment only business primarily due to fees received from an early extinguishment of medium-term notes.

Net investment income decreased primarily due to lower investment returns on invested assets and cash, which related to our move to a more liquid investment strategy for the segment.

Total Expenses

Benefits, claims and settlement expenses decreased \$196.2 million in our investment only business primarily due to our decision to scale back this business and lower variable crediting rates. In addition, our full service payout business benefits, claims and settlement expenses decreased \$131.3 million primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies. Furthermore, benefits, claims and settlement expenses decreased \$68.9 million in our individual annuities business primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies, partially offset by an increase in interest credited and an increase in benefit expense related to a growing block of fixed annuities.

Operating expenses in our full service accumulation business decreased \$112.9 million primarily due to a decrease in DPAC amortization, which related to an adjustment for prior periods and an improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of 2008. To a lesser extent, a decrease in expenses due to expense savings initiatives and lower fees paid to advisors, which resulted from a decrease in average account values, contributed to the decline in operating expenses in our full service accumulation business. In addition, operating expenses within Principal Funds decreased \$82.2 million primarily due to lower commission expense and fees paid to advisors resulting from a decrease in average account values. Furthermore, operating expenses in our individual annuities business decreased \$23.0 million primarily due to a decrease in DPAC amortization related to favorable true-up impacts stemming from an improvement in equity markets during the third quarter of 2009, compared to a decline in equity markets during the third quarter of

2008. Also, to a lesser extent, a decrease in non-deferred commission expense resulting from a decline in sales of annuities with life contingencies contributed to the decrease in operating expenses within our individual annuities business.

Income Taxes

The effective income tax rate for the segment was 22% for both the nine months ended September 30, 2009 and 2008. The effective income tax rate was lower than the U.S. statutory rate primarily as a result of income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income.

Table of Contents**Global Asset Management Segment***Global Asset Management Segment Summary Financial Data*

AUM is a key indicator of earnings growth for our Global Asset Management segment, as AUM is the base by which we generate revenues. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects equity, fixed income and real estate market performance. The percentage growth or decline in earnings of the segment will generally track with the percentage growth or decline in AUM. This trend may vary due to changes in business and/or product mix.

The following table provides the AUM rollforward for assets managed by Global Asset Management for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
(in billions)								
AUM, beginning of period	\$	190.9	\$	233.0	\$	190.0	\$	236.0
Net cash flow (1)		(0.8)		1.9		(4.0)		9.2
Investment performance		15.2		(15.2)		23.8		(22.9)
Operations disposed (2)						(3.8)		
Other		0.8		(1.6)		0.1		(4.2)
AUM, end of period	\$	206.1	\$	218.1	\$	206.1	\$	218.1

(1) Includes net cash flow of \$(0.8) billion and \$(3.9) billion for the three and nine months ended September 30, 2009, respectively, resulting from the U.S. Asset Accumulation segment's decision to scale back its investment only business.

(2) Includes disposition of certain asset management contracts within Post Advisory Group, LLC.

The following table presents certain summary financial data relating to the Global Asset Management segment for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,							
	2009		2008		2009		2008					
(in millions)												
Operating revenues:				Increase (decrease)				Increase (decrease)				
Fees and other revenues	\$	108.5	\$	136.6	\$	(28.1)	\$	312.3	\$	406.4	\$	(94.1)
Net investment income		2.8		5.1		(2.3)		6.7		18.6		(11.9)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Total operating revenues	111.3	141.7	(30.4)	319.0	425.0	(106.0)
Expenses:						
Total expenses	93.1	103.1	(10.0)	276.3	313.5	(37.2)
Operating earnings before income taxes and noncontrolling interest	18.2	38.6	(20.4)	42.7	111.5	(68.8)
Income taxes	6.2	11.9	(5.7)	14.3	35.8	(21.5)
Operating earnings attributable to noncontrolling interest	1.5	3.2	(1.7)	2.9	8.3	(5.4)
Operating earnings	\$ 10.5	\$ 23.5	\$ (13.0)	\$ 25.5	\$ 67.4	\$ (41.9)

Table of Contents

Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008

Operating Earnings

The severe downturn in global financial markets in 2008 has led to a significant reduction in our AUM and revenues and thus a reduction in operating earnings. This decline was offset in part by a series of expense savings initiatives, which have been undertaken in response to the market downturn.

Operating Revenues

Fees decreased primarily due to a decrease in AUM as a result of declining market conditions and, to a lesser extent, the 2009 sale of certain asset management contracts within Post Advisory Group, LLC. In addition, borrower fees and real estate transaction fees decreased due to a decline in real estate activity.

Net investment income decreased as a result of the declining interest rate environment and lower investment income earned on our loan portfolio.

Total Expenses

Total expenses decreased primarily due to lower staff related costs resulting from expense savings initiatives.

Income Taxes

The effective income tax rates for the segment were 34% and 31% for the three months ended September 30, 2009 and 2008, respectively. The effective income tax rate was lower than the U.S. statutory rate, primarily due to the inclusion of income attributable to noncontrolling interest in pre-tax operating earnings with no corresponding change in income taxes reported by us as the controlling interest. The effective income tax rate increased to 34% from 31% for the three months ended September 30, 2009 and 2008, respectively, primarily due to a third quarter 2008 adjustment to reflect a decrease in our estimated 2008 annual effective income tax rate.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Earnings

The severe downturn in global financial markets in 2008 has led to a significant reduction in our AUM and revenues and thus a reduction in operating earnings. This decline was offset in part by a series of expense savings initiatives, which have been undertaken in response to the market downturn.

Operating Revenues

Fees decreased primarily due to a decrease in AUM as a result of declining market conditions and, to a lesser extent, the 2009 sale of certain asset management contracts within Post Advisory Group, LLC. In addition, borrower fees and real estate transaction fees decreased due to a decline in real estate activity.

Net investment income decreased as a result of the declining interest rate environment, lower investment income earned on our loan portfolio and a decline in earnings from our equity method investment.

Total Expenses

Total expenses decreased primarily due to lower staff related costs resulting from expense savings initiatives.

Table of Contents**Income Taxes**

The effective income tax rates for the segment were 33% and 32% for the nine months ended September 30, 2009 and 2008, respectively. The effective income tax rate was lower than the U.S. statutory rate, primarily due to the inclusion of income attributable to noncontrolling interest in pre-tax operating earnings with no corresponding change in income taxes reported by us as the controlling interest.

International Asset Management and Accumulation Segment*International Asset Management and Accumulation Segment Summary Financial Data*

AUM is a key indicator of earnings growth for the segment, as AUM is the base by which we can generate profits. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects the investment returns on our underlying AUM. The percentage growth or decline in the earnings of our International Asset Management and Accumulation segment will generally track with the percentage growth or decline in AUM. This trend may vary due to changes in business and/or product mix. Our AUM and financial results are also impacted by fluctuations of foreign currency to U.S. dollar exchange rates for the countries in which we have business.

The following table presents the International Asset Management and Accumulation AUM rollforward for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
(in billions)								
AUM, beginning of period	\$	28.7	\$	30.0	\$	23.1	\$	28.7
Net cash flow		0.6		(0.5)		2.3		0.7
Investment performance		1.5		(0.3)		3.2		(0.7)
Effect of exchange rates		0.6		(0.7)		3.0		
Other				0.1		(0.2)		(0.1)
AUM, end of period	\$	31.4	\$	28.6	\$	31.4	\$	28.6

The following table presents certain summary financial data of the International Asset Management and Accumulation segment for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
(in millions)								
				Increase (decrease)				Increase (decrease)

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Operating revenues:												
Premiums and other considerations	\$	67.8	\$	47.0	\$	20.8	\$	184.0	\$	186.8	\$	(2.8)
Fees and other revenues		30.7		31.1		(0.4)		83.2		100.0		(16.8)
Net investment income		57.6		187.4		(129.8)		114.6		413.6		(299.0)
Total operating revenues		156.1		265.5		(109.4)		381.8		700.4		(318.6)
Expenses:												
Benefits, claims and settlement expenses		92.0		184.8		(92.8)		218.4		488.7		(270.3)
Operating expenses		31.3		38.1		(6.8)		81.1		113.3		(32.2)
Total expenses		123.3		222.9		(99.6)		299.5		602.0		(302.5)
Operating earnings before income taxes and noncontrolling interest		32.8		42.6		(9.8)		82.3		98.4		(16.1)
Income taxes (benefits)		(0.2)		(0.9)		0.7		3.0		(8.7)		11.7
Operating loss attributable to noncontrolling interest		(0.1)		(0.9)		0.8		(0.1)		(0.8)		0.7
Operating earnings	\$	33.1	\$	44.4	\$	(11.3)	\$	79.4	\$	107.9	\$	(28.5)

Table of Contents

Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008

Operating Earnings

Operating earnings decreased primarily due to lower investment returns on assets not backing segment insurance products as a result of deflation in Chile during 2009 and weakening currencies in Latin America, which were partially offset by expense savings initiatives for the segment in 2009.

Operating Revenues

Premiums in Chile increased \$20.8 million primarily due to higher sales of single premium annuities with life contingencies partially offset by the weakening of the Chilean peso against the U.S. dollar.

Fees and other revenue decreased \$3.3 million in Mexico primarily due to the weakening of the Mexican peso against the U.S. dollar, which was partially offset by higher investment management fees driven by higher AUM. Partially offsetting this decrease was a \$1.6 million increase in India primarily due to reduced fees charged in third quarter 2008 due to market conditions. In addition, fees and other revenue increased \$1.2 million in Chile primarily due to higher unearned revenue (UREV) amortization resulting from true-up adjustments and higher inflation-based interest on UREV.

Net investment income decreased primarily due to lower investment returns on average invested assets and cash, excluding our equity method investments, as a result of deflation in Chile in 2009.

Total Expenses

Benefits, claims and settlement expenses decreased \$88.5 million in Chile, primarily due to lower interest crediting rates to customers, which are impacted by deflation similar to net investment income, and the weakening of the Chilean peso against the U.S. dollar.

Operating expenses in Chile decreased \$2.9 million primarily due to expense savings initiatives. In addition, operating expenses in India decreased \$2.9 million primarily due to a reduction in fund expenses passed to our asset management company and expense savings initiatives in 2009.

Income Taxes

The effective income tax rates for this segment were (1)% and (2)% for the three months ended September 30, 2009 and 2008, respectively. The effective income tax rates for the three months ended September 30, 2009 and 2008, were lower than the U.S. statutory rate, primarily as a result of taxes on our share of earnings generated from equity method investments being reflected in net investment income and lower tax rates of foreign jurisdictions. The effective income tax rates were negative as a result of the benefit of U.S. deferred tax credits related to our equity method investment in Brazil. The deferred tax credits arise because of the difference between the Brazil statutory tax rate of 40% and the U.S. statutory tax rate of 35%.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Earnings

Operating earnings decreased primarily due to lower investment returns on assets not backing segment insurance products as a result of deflation in Chile during 2009 coupled with weakening currencies in Latin America, which were partially offset by increased earnings in our equity method investment in Brazil as a result of realized investment gains in 2009 and higher fee revenues coupled with expense savings initiatives for the segment in 2009.

Operating Revenues

Premiums in Chile decreased \$2.4 million primarily due to the weakening of the Chilean peso against the U.S. dollar, which was partially offset by higher sales of single premium annuities with life contingencies.

Fees and other revenues in Mexico and Chile decreased \$16.0 million primarily due to the weakening of the Mexican peso and Chilean peso against the U.S. dollar.

Table of Contents

Net investment income decreased primarily due to lower investment returns on average invested assets and cash, excluding our equity method investments, as a result of deflation in Chile in 2009.

Total Expenses

Benefits, claims and settlement expenses decreased \$260.9 million in Chile, primarily due to lower interest crediting rates to customers, which are impacted by deflation similar to net investment income, and the weakening of the Chilean peso against the U.S. dollar.

Operating expenses in Mexico decreased \$13.1 million primarily due to the weakening of the Mexican peso against the U.S. dollar, expense savings initiatives in 2009 and lower present value of future profits and DPAC amortization largely resulting from net unlocking and true-up adjustments. In addition, operating expenses in Chile decreased \$8.0 million primarily due to the weakening of the Chilean peso against the U.S. dollar and expense savings initiatives in 2009. Furthermore, operating expenses in India decreased \$7.3 million primarily due to a reduction in fund expenses passed to our asset management company and expense savings initiatives in 2009.

Income Taxes

The effective income tax rates for this segment were 4% and (9)% for the nine months ended September 30, 2009 and 2008, respectively. The effective income tax rate for the nine months ended September 30, 2009, was lower than the U.S. statutory rate, primarily as a result of taxes on our share of earnings generated from equity method investments being reflected in net investment income and lower tax rates of foreign jurisdictions. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate, primarily due to additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate, taxes on our share of earnings generated from our equity method investments that are included in net investment income and lower tax rates of foreign jurisdictions. The Brazil tax rate change did not impact operating earnings because a U.S. foreign tax credit was allowed for the increase in Brazil deferred income taxes; however, it did impact the effective tax rate because our Brazilian subsidiary is reported on the equity method of accounting. The impact of the increased Brazil deferred income taxes flowed through pre-tax income but the decrease in income taxes due to the U.S. foreign tax credits was reflected in income taxes, the result of which was a decrease to the effective tax rate.

Life and Health Insurance Segment

Individual Life Insurance Trends

Our life insurance premiums are influenced by both economic and industry trends. In addition, we continue to shift our marketing emphasis to universal life insurance products from traditional life insurance products. Due to this shift in marketing emphasis, premiums related to our traditional life insurance products have declined, while fee revenues from our universal and variable universal life insurance products have grown.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The following table provides a summary of our individual universal and variable universal life insurance fee revenues and our individual traditional life insurance premiums for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
	(in millions)							
Universal and variable universal life insurance fee revenue	\$	90.8	\$	83.5	\$	258.9	\$	247.0
Traditional life insurance premiums		134.1		143.6		414.7		442.8

Table of Contents***Health Insurance Trends***

We have experienced lower premium revenue as increases in premium per member have been more than offset by a decrease in average covered medical members.

Our health insurance premium and fees were as follows for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
	(in millions)							
Premium and fees:								
Group medical insurance	\$	365.5	\$	395.1	\$	1,130.3	\$	1,223.0
Fee-for-service		32.6		35.7		99.8		108.4

Specialty Benefits Insurance Trends

Premium and fees for our specialty benefits insurance business decreased slightly due to the economic impact on employment levels of our existing employer customers as well as higher lapses, particularly in the first half of 2009, caused by competitive market conditions and pricing discipline.

The following table provides a summary of our specialty benefits insurance premium and fees for the periods indicated:

	For the three months ended September 30,				For the nine months ended September 30,			
	2009		2008		2009		2008	
	(in millions)							
Premium and fees:								
Group dental and vision insurance	\$	134.3	\$	140.2	\$	406.4	\$	417.7
Group life insurance		82.8		87.3		250.8		262.2
Group disability insurance		71.9		73.7		218.6		227.3
Individual disability insurance		46.3		43.1		135.6		128.5

Life and Health Insurance Segment Summary Financial Data

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

There are several key indicators for earnings growth in our Life and Health Insurance segment. The ability of our distribution channels to generate new sales and retain existing business drives growth in our block of business, premium revenue and fee revenues. Our earnings growth also depends on our ability to price our products at a level that enables us to earn a margin over the cost of providing benefits and the expense of acquiring and administering those products. Factors impacting pricing decisions include competitive conditions, persistency, our ability to assess and manage trends in mortality and morbidity experience and our ability to manage operating expenses.

Table of Contents

The following table presents certain summary financial data relating to the Life and Health Insurance segment for the periods indicated:

	For the three months ended September 30,			For the nine months ended September 30,		
	2009	2008	Increase (decrease)	2009	2008	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	\$ 803.9	\$ 855.0	\$ (51.1)	\$ 2,462.1	\$ 2,620.1	\$ (158.0)
Fees and other revenues	134.3	130.5	3.8	393.6	390.7	2.9
Net investment income	166.0	173.4	(7.4)	496.4	516.3	(19.9)
Total operating revenues	1,104.2	1,158.9	(54.7)	3,352.1	3,527.1	(175.0)
Expenses:						
Benefits, claims and settlement expenses	693.3	710.7	(17.4)	2,109.7	2,160.5	(50.8)
Dividends to policyholders	61.2	69.8	(8.6)	185.8	208.3	(22.5)
Operating expenses	247.6	268.2	(20.6)	761.6	830.0	(68.4)
Total expenses	1,002.1	1,048.7	(46.6)	3,057.1	3,198.8	(141.7)
Operating earnings before income taxes	102.1	110.2	(8.1)	295.0	328.3	(33.3)
Income taxes	33.9	36.3	(2.4)	97.3	108.5	(11.2)
Operating earnings	\$ 68.2	\$ 73.9	\$ (5.7)	\$ 197.7	\$ 219.8	\$ (22.1)

*Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008***Operating Earnings**

Operating earnings in our health insurance business decreased \$9.5 million primarily due to higher claim costs per member and a decrease in average covered medical members. In addition, operating earnings in our specialty benefits insurance business decreased \$4.8 million due to adverse impacts of the economic environment on premium growth and investment income and due to an increase in employee pension and other post-retirement benefit costs. Partially offsetting these decreases was an \$8.6 million increase in our individual life insurance business due to lower DPAC amortization related to favorable true-up impacts stemming from improved equity market performance during the quarter.

Operating Revenues

Premiums decreased \$28.9 million in our health insurance business due to a reduction in average covered medical members, as lapses were greater than new sales. Premiums decreased \$13.5 million in our individual life insurance business primarily due to the expected continued decline from the decreasing block of traditional life insurance business. In addition, premiums decreased \$8.7 million in our specialty benefits insurance business due to a decline in employment levels of our existing employer customers and an increase in lapse rates in the first half of 2009.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Fees and other revenues increased \$7.9 million in our individual life insurance business primarily due to growth in the universal life and variable universal life insurance lines of business. Fees and other revenues decreased \$3.8 million in our health insurance business, largely due to a decrease in average fee-for-service medical members.

Net investment income decreased primarily due to lower investment returns on invested assets and cash related to our more liquid investment strategy for the segment.

Total Expenses

Benefits, claims and settlement expenses decreased \$12.2 million in our health insurance business due to a decrease in average covered medical members partially offset by higher claim costs per member. In addition, benefits, claims and settlement expenses decreased \$4.2 million in our specialty benefits insurance business due to a slight improvement in the division-wide loss ratio.

Dividends to policyholders decreased primarily from updating the policyholder dividend scale to reflect the experience of the Closed Block.

Table of Contents

Operating expenses decreased \$11.4 million in our individual life insurance business primarily related to lower DPAC amortization and lower non-deferred sales-related expenses. In addition, operating expenses decreased \$8.4 million in our health insurance business primarily due to actively managing expenses to align with a decline in insured medical and fee-for-service members.

Income Taxes

The effective income tax rate for this segment was 33% for both the three months ended September 30, 2009 and 2008. The effective income tax rate was lower than the U.S. statutory rate as a result of the interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Earnings

Operating earnings in our specialty benefits insurance business decreased \$18.8 million due to the adverse impacts of the economic environment on premium growth and investment income and due to an increase in employee pension and other post-retirement benefit costs. In addition, this decrease was due to a favorable change in reserve assumptions related to our individual disability business in the prior period, with no comparable change in the current period. Operating earnings in our health insurance business decreased \$18.4 million primarily due to higher claim costs per member and a decrease in average covered medical members. Partially offsetting these decreases was a \$15.1 million increase in our individual life insurance business primarily due to updating the dividend scale to reflect the experience of the Closed Block and due to lower DPAC amortization related to favorable true-up impacts stemming from improved equity market performance.

Operating Revenues

Premiums decreased \$90.9 million in our health insurance business due to a reduction in average covered medical members, as lapses were greater than new sales. Premiums decreased \$43.3 million in our individual life insurance business primarily due to the expected continued decline from the decreasing block of traditional life insurance business and an increase in reinsurance on growing blocks of universal life and variable universal life insurance lines of business. In addition, premiums decreased \$23.8 million in our specialty benefits insurance business due to a decline in employment levels of our existing employer customers and an increase in lapse rates during the first half of 2009.

Fees and other revenues increased \$13.5 million in our individual life insurance business primarily related to our universal life and variable universal life insurance lines of business where growth in fees from renewals more than offset lower first year fees resulting from a decline in sales. Partially offsetting this increase was a \$10.2 million decrease in our health insurance business, largely due to a decrease in average fee-for-service medical members.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net investment income decreased primarily due to lower investment returns on invested assets and cash related to our more liquid investment strategy for the segment.

Total Expenses

Benefits, claims and settlement expenses decreased \$58.0 million in our health insurance business due to a decrease in average covered medical members partially offset by higher claim costs per member. Partially offsetting this decrease was a \$10.1 million increase in benefits, claims and settlement expenses for our individual life insurance business due to higher cost of interest credited related to growth in the universal life and variable universal life insurance lines of business.

Dividends to policyholders decreased primarily from updating the policyholder dividend scale to reflect the experience of the Closed Block.

Operating expenses decreased \$44.0 million in our individual life insurance business primarily related to lower DPAC amortization and lower non-deferred sales-related expenses. In addition, operating expenses decreased \$22.9 million in our health insurance business primarily due to actively managing expenses to align with a decline in insured medical and fee-for-service members.

Table of Contents**Income Taxes**

The effective income tax rate for this segment was 33% for both the nine months ended September 30, 2009 and 2008. The effective income tax rate was lower than the U.S. statutory rate as a result of the interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

Corporate Segment*Corporate Segment Summary Financial Data*

The following table presents certain summary financial data relating to the Corporate segment for the periods indicated:

	For the three months ended September 30,			For the nine months ended September 30,		
	2009	2008	Increase (decrease)	2009	2008	Increase (decrease)
	(in millions)					
Operating revenues:						
Total operating revenues	\$ (40.1)	\$ (52.4)	\$ 12.3	\$ (123.2)	\$ (152.3)	\$ 29.1
Expenses:						
Total expenses	(2.3)	(25.7)	23.4	(21.4)	(78.1)	56.7
Operating losses before income taxes and preferred stock dividends	(37.8)	(26.7)	(11.1)	(101.8)	(74.2)	(27.6)
Income tax benefits	(18.3)	(7.8)	(10.5)	(42.0)	(39.0)	(3.0)
Preferred stock dividends	8.2	8.2		24.7	24.7	
Operating losses	\$ (27.7)	\$ (27.1)	\$ (0.6)	\$ (84.5)	\$ (59.9)	\$ (24.6)

*Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008***Operating Losses**

Operating losses increased minimally due to higher interest expense on corporate debt offset by increased income tax benefits due to the establishment of state deferred income tax liabilities associated with the intended change in filing status of a subsidiary in 2008 with no corresponding activity in 2009.

Operating Revenues

Operating revenues increased primarily due to a decrease in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses.

Total Expenses

Total expenses increased due to a decrease in inter-segment eliminations included in this segment, which was offset by a corresponding change in operating revenues. In addition, total expenses increased due to higher interest expense on corporate debt as well as an increase in net amounts credited to employee accounts in a nonqualified defined contribution pension plan.

Income Taxes

Income tax benefits increased due to an increase in operating losses before income taxes. Also contributing to the increase in income tax benefits was the establishment of state deferred income tax liabilities associated with the intended change in filing status of a subsidiary in 2008 with no corresponding activity in 2009.

Table of Contents

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Operating Losses

Operating losses increased due to higher interest expense on corporate debt. In addition, operating losses increased due to the release of state deferred income tax liabilities associated with the reorganization of certain subsidiaries in 2008 with no corresponding activity in 2009. Further contributing to increased operating losses was an increase in the net amounts credited to employee accounts in a nonqualified defined contribution pension plan.

Operating Revenues

Operating revenues increased due to a decrease in inter-segment eliminations included in this segment, which was mostly offset by a corresponding change in total expenses. Partially offsetting this increase in operating revenues was a decline in average investment yields, resulting primarily from decreased earnings on equity real estate investments.

Total Expenses

Total expenses increased due to a decrease in inter-segment eliminations included in this segment, which was offset by a corresponding change in operating revenues. In addition, total expenses increased due to higher interest expense on corporate debt and an increase in net amounts credited to employee accounts in a nonqualified defined contribution pension plan.

Income Taxes

Income tax benefits increased due to an increase in operating losses before income tax. Partially offsetting the increase in income tax benefits was the release of state deferred income tax liabilities associated with the reorganization of certain subsidiaries in 2008 with no corresponding activity in 2009.

Liquidity and Capital Resources

Liquidity and capital resources represent the overall strength of a company and its ability to generate strong cash flows, borrow funds at a competitive rate and to raise new capital to meet operating and growth needs. Our legal entity structure has an impact on our ability to meet cash flow needs as an organization. Following is a simplified organizational structure.

Our liquidity requirements have been and will continue to be met by funds from consolidated operations as well as the issuance of commercial paper, common stock, debt or other capital securities and borrowings from credit facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of our operations, including reasonably foreseeable contingencies.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term payment obligations. As evidenced by our second quarter 2009 equity and debt issuances, with the uncertainty surrounding the length and severity of the current global recession we believe it is a prudent capital management practice to continue to explore any and all options available to us to maximize capital flexibility, including accessing the capital markets, utilizing our commercial paper program, cost cutting and internal efficiency initiatives and transactions with strategic and other investors.

Table of Contents

Although approximately \$16.1 billion, or 99%, of our institutional guaranteed investment contracts (GICs) and funding agreements cannot be redeemed by contractholders prior to maturity and our life insurance and annuity liabilities contain provisions limiting early surrenders, given market conditions we have maintained a historically high position of cash and cash equivalent holdings through 2009. As a result of increased current cash holdings, yields will be lower than historically experienced. Our liquidity is supported by an increasing portfolio of government-backed securities, of which we held \$4.1 billion as of September 30, 2009, an increase of over \$1.0 billion since December 31, 2008, that may be utilized to bolster our liquidity position through alternative secured borrowing transactions with various third parties, disposing of securities into the open market or accessing advances via our Federal Home Loan Bank of Des Moines membership, if needed.

In response to the market dislocation affecting the banking system and financial markets, various government institutions have established economic stabilization programs. As a savings and loan holding company subject to oversight of the Office of Thrift Supervision, we applied to participate in the U.S. Department of the Treasury's Capital Purchase Program (CPP) and were notified of preliminary approval of our application to participate in May 2009. However, on June 11, 2009, we announced that we had declined to participate in the CPP.

As a savings and loan holding company, we are eligible to participate in the Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program (TLGP). To issue debt under the program, however, the FDIC requires all savings and loan holding companies to apply for an exception to establish a debt guarantee limit. Increasing inter-bank lending is one of the primary purposes of the program. The FDIC pointed to our lack of participation in inter-bank lending as one of several reasons it was not likely to grant an exception. As a result, we withdrew our TLGP application during first quarter 2009.

PFS was previously accepted for the Federal Reserve's Commercial Paper Funding Facility (CPFF). Under the program, our commercial paper must maintain ratings of at least A-1/P-1/F-1 by at least two ratings agencies. S&P and Moody's downgraded PFS's commercial paper rating in the first quarter of 2009; consequently, PFS is no longer eligible to issue commercial paper under the CPFF. As of September 30, 2009, PFS had no commercial paper outstanding under the CPFF.

As of September 30, 2009, we had credit facilities with various financial institutions in an aggregate amount of \$834.4 million. As of September 30, 2009 and December 31, 2008, we had \$107.1 million and \$500.9 million, respectively, of outstanding unsecured borrowings under the credit facilities. Our credit facilities include a \$579.0 million commercial paper program, of which we had \$87.0 million outstanding as of September 30, 2009. Our commercial paper program has a back-stop facility to provide 100% support for our commercial paper program, of which there were no outstanding balances as of September 30, 2009.

The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc. The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and to raise capital to meet operating and growth needs. Dividends from Principal Life, our primary subsidiary, are limited by Iowa law. Under Iowa law, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa (the Commissioner) to pay a stockholder dividend if such a stockholder dividend would exceed certain statutory limitations. In general, the current statutory limitation is the greater of (i) 10% of Principal Life's statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year. Under this limitation, Principal Life could pay approximately \$651.3 million in stockholder dividends in 2009 without exceeding the statutory limitation. On March 27, 2009, a \$645.0 million ordinary dividend was paid by Principal Life to its parent company from internal sources of liquidity. Following our issuance of debt and equity, on May 20, 2009, a \$500.0 million capital contribution was made to Principal Life from its parent company.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Operations. Our primary consolidated cash flow sources are premiums from life and health insurance products, pension and annuity deposits, asset management fee revenues, administrative services fee revenues, income from investments and proceeds from the sales or maturity of investments. Cash outflows consist primarily of payment of benefits to policyholders and beneficiaries, income and other taxes, current operating expenses, payment of dividends to policyholders, payments in connection with investments acquired, payments made to acquire subsidiaries, payments relating to policy and contract surrenders, withdrawals, policy loans, interest expense and repayment of short-term debt and long-term debt. Our investment strategies are generally intended to provide adequate funds to pay benefits without forced sales of investments. For a discussion

Table of Contents

of our investment objectives, strategies and a discussion of duration matching, see *Investments* as well as Item 3. *Quantitative and Qualitative Disclosures about Market Risk* *Interest Rate Risk*.

Cash Flows. Activity, as reported in our consolidated statements of cash flows, provides relevant information regarding our sources and uses of cash.

Net cash provided by operating activities was \$1,794.4 million and \$1,867.2 million for the nine months ended September 30, 2009 and 2008, respectively. As an insurance business, we typically generate positive cash flows from operating activities, as premiums collected from our insurance products and income received from our investments exceed policy acquisition costs, benefits paid, redemptions and operating expenses. These positive cash flows are then invested to support the obligations of our insurance and investment products and required capital supporting these products. Our cash flows from operating activities are affected by the timing of premiums, fees and investment income received and benefits and expenses paid. The decrease in cash provided by operating activities in 2009 compared to 2008 was primarily due to a decrease in revenues received. This decrease was partially offset by a change in cash flows from trading securities as we have held and are holding higher cash balances to cover potential near-term obligations and to further reposition our investment portfolio as necessary, as well as a decrease in cash paid for benefits and other operating expenses.

Net cash provided by investing activities was \$1,156.2 million for the nine months ended September 30, 2009, compared to net cash used in investing activities of \$4,018.3 million for the nine months ended September 30, 2008. The increase in cash provided by investing activities in 2009 compared to 2008 was primarily the result of a decrease in net purchases of investments in 2009 as we have held and are holding higher cash balances to cover potential near term obligations and to further reposition our investment portfolio as necessary. We do sell bonds under certain circumstances, such as when we have evidence of a significant deterioration in the issuer's creditworthiness, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities.

Net cash used in financing activities was \$2,317.4 million for the nine months ended September 30, 2009, compared to net cash provided by financing activities of \$3,075.7 million for the nine months ended September 30, 2008. The increase in cash used by financing activities in 2009 compared to 2008 is primarily due to an increase in net withdrawals of investment contracts, partially due to our decision to scale back our investment only business, offset in part by proceeds from the issuance of common stock and long-term debt in the current year. The proceeds from the debt issuance were primarily used to refinance notes that matured on August 15, 2009.

On October 26, 2009, our Board of Directors declared an annual common stock dividend of approximately \$159.5 million, equal to \$0.50 per share, payable on December 4, 2009, to common stockholders of record as of November 13, 2009.

Shelf Registration. We currently have an effective shelf registration which allows us the ability to issue, in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration. In May 2009, we issued common stock and senior debt securities under the shelf registration.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Preferred Stock Dividend Restrictions and Payments. The certificates of designation for the Series A and B Preferred Stock restrict the declaration of preferred dividends if we fail to meet specified capital adequacy, net income or stockholders' equity levels. As of September 30, 2009, we have no preferred dividend restrictions. The dividend payments on our preferred equity are not mandatory or cumulative, as our Board of Directors approves each quarterly dividend payment.

Short-Term Debt. The components of short-term debt as of September 30, 2009, and December 31, 2008, were as follows:

	September 30, 2009	December 31, 2008
	(in millions)	
Commercial paper	\$ 87.0	\$ 482.3
Other recourse short-term debt	20.1	18.6
Total short-term debt	\$ 107.1	\$ 500.9

Table of Contents

Long-Term Debt. On May 18, 2009, we issued \$750.0 million of senior debt securities. We issued a \$400.0 million series of notes that bear interest at 7.875% and will mature on May 15, 2014, and a \$350.0 million series of notes that bear interest at 8.875% and will mature on May 15, 2019. Interest on the notes is payable semi-annually on May 15 and November 15 each year, beginning on November 15, 2009. The proceeds were primarily used to refinance \$440.9 million of notes that matured on August 15, 2009, with the remaining proceeds being used for general corporate purposes.

Stockholders Equity. In May 2009, we issued 58.2 million shares of common stock at a price of \$19.75 per share. Net proceeds from the issuance were \$1,109.1 million. The proceeds from this offering will be used for general corporate purposes. For additional stockholders equity information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Stockholders Equity.

Capitalization

Our capital structure as of September 30, 2009, and December 31, 2008, consisted of debt and equity summarized as follows:

	September 30, 2009		December 31, 2008	
	(in millions)			
Debt:				
Short-term debt	\$	107.1	\$	500.9
Long-term debt		1,586.1		1,290.5
Total debt		1,693.2		1,791.4
Stockholders equity:				
Equity attributable to Principal Financial Group, Inc. excluding accumulated other comprehensive income		8,942.8		7,384.4
Total capitalization excluding accumulated other comprehensive income	\$	10,636.0	\$	9,175.8
Debt to equity excluding accumulated other comprehensive income		19%		24%
Debt to capitalization excluding accumulated other comprehensive income		16%		20%

As of September 30, 2009, we have \$1,254.5 million of excess capital, consisting of cash and highly liquid assets in the holding companies available for debt maturities, interest and preferred dividend expenses and other holding company obligations. We continue to maintain sufficient capital levels in Principal Life based on our current financial strength ratings.

Contractual Obligations and Contractual Commitments

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

As of September 30, 2009, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2008.

Off-Balance Sheet Arrangements

Variable Interest Entities. As of September 30, 2009, there have been no significant changes to variable interest entities since December 31, 2008.

Guarantees and Indemnifications. As of September 30, 2009, there have been no significant changes to guarantees and indemnifications since December 31, 2008. For guarantee and indemnification information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Contingencies, Guarantees and Indemnifications under the caption, Guarantees and Indemnifications.

Financial Strength Rating and Credit Ratings

Our ratings are influenced by many factors including our operating and financial performance, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), risk exposures, operating leverage and other factors.

Nationally Recognized Statistical Rating Organizations (NRSROs) publish financial strength ratings on U.S. life insurance companies that are indicators of an insurance company's ability to meet contractholder and policyholder obligations. NRSROs also assign credit ratings on non-life insurance entities, such as PFG and PFS. Credit ratings are indicators of a debt

Table of Contents

issuer's ability to meet the terms of debt obligations in a timely manner, and are important factors in overall funding profile and ability to access external capital. Such ratings are not a recommendation to buy, sell or hold securities. Ratings are subject to revision or withdrawal at any time by the assigning NRSRO, and each rating should be evaluated independently of any other rating.

Ratings are important factors in establishing the competitive position of insurance companies and maintaining public confidence in products being offered. A ratings downgrade, or the potential for such a downgrade, could, among other things: (i) lead to a material increase in the number of surrenders for all or a portion of the net cash values by the owners of policies and contracts and materially increase the number of withdrawals by policyholders of cash values from their policies; (ii) result in the termination of our relationships with broker-dealers, banks, agents, wholesalers and other distributors of our products and services; (iii) result in a reduction of new sales; (iv) cause some of our existing obligations to be subject to additional collateral support, changes in terms or creation of additional financial obligations and (v) increase our cost of capital and limit our access to the capital markets. Any of these consequences could adversely affect our profitability and financial condition.

Each of A.M. Best Company, Inc., Fitch Ratings Ltd., Moody's Investors Service, and Standard & Poor's revised its outlook for the U.S. life insurance sector to negative from stable in mid-to-late 2008. Of the many issues cited, the negative outlook was primarily based on expectations for higher-than-normal credit losses, negative impact of the volatile equity market on earnings and reduced financial flexibility. These outlook revisions signal increased review of the U.S. life insurance sector by the major independent rating organizations. As a result, it is possible there will be changes in the benchmarks for capital, liquidity, earnings and other factors used by these NRSROs that are critical to a ratings assignment at a particular rating level. If any such changes are made, it is possible that such changes could have an impact on the ratings of U.S. life insurance companies, including ours, which could adversely impact our profitability and financial condition.

As a reflection of the change by the rating agencies of their view of the market and the impact on life insurance companies, Principal Life experienced negative rating actions by the agencies in the first quarter of 2009. In the second quarter of 2009, there were positive actions taken on Principal Life's rating outlook subsequent to the issuance of equity and debt. On May 13, 2009, S&P affirmed Principal Life's insurance financial strength rating of A+ and changed the outlook to positive from stable. Similarly, on May 13, 2009, Fitch affirmed Principal Life's insurance financial strength rating of AA-, and changed the outlook to negative from rating watch negative. Further on May 20, 2009, Moody's affirmed Principal Life's insurance financial strength rating of Aa3 and changed the outlook to stable from negative. AM Best made no rating or outlook changes during the quarter; they maintain the negative outlook on Principal Life's insurance financial strength rating of A+. The changes in the outlook on Principal Life's ratings indicate the positive view that the agencies have on our debt and equity issuances; however, even though Principal Life has not experienced any material effects from the rating agencies' actions, there is still concern about the potential impact of the equity market turmoil on Principal Life's financial flexibility.

In July 2009, Principal National Life Insurance Company (PNLIC) financial strength ratings were publicly announced. PNLIC has been established to write individual life insurance products in 49 states. Initially only fixed products will be sold, with variable products being added at a later date.

The following table summarizes our significant financial strength and debt ratings from the major independent rating organizations. The debt ratings shown are indicative ratings. Outstanding issuances are rated the same as indicative ratings unless otherwise noted. Actual ratings can differ from indicative ratings based on contractual terms.

	A.M. Best	Fitch	Standard & Poor's	Moody's
Principal Financial Group				

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Senior Unsecured Debt (1)				BBB+	Baa1
Preferred Stock (2)				BBB-	Baa3
Principal Financial Services					
Senior Unsecured Debt				BBB+	
Commercial Paper			F-1	A-2	P-2
Principal Life Insurance Company					
Insurer Financial Strength	A+	AA-		A+	Aa3
Enterprise Risk Management Rating				Strong	
Principal National Life Insurance Company					
Insurer Financial Strength	A+	AA-		A+	Aa3

Table of Contents

- (1) Moody's has rated Principal Financial Group's senior debt issuance A3
- (2) S&P has rated Principal Financial Group's preferred stock issuance BB+

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels for disclosure purposes. The fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and gives the lowest priority (Level 3) to unobservable inputs. An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Fair Value of Financial Instruments for further details.

As of September 30, 2009, 39% of our net assets (liabilities) were Level 1, 56% were Level 2 and 5% were Level 3. Excluding separate account assets as of September 30, 2009, 2% of our net assets (liabilities) were Level 1, 96% were Level 2 and 2% were Level 3.

As of December 31, 2008, 32% of our net assets (liabilities) were Level 1, 61% were Level 2 and 7% were Level 3. Excluding separate account assets as of December 31, 2008, 2% of our net assets (liabilities) were Level 1, 95% were Level 2 and 3% were Level 3.

Changes in Level 3 fair value measurements

The net change for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2009, was as follows:

	Balance as of		Balance as of		Net change	
	September 30, 2009		December 31, 2008			
	(in millions)					
Assets						
Total fixed maturities, available-for-sale	\$	1,150.9	\$	1,173.0	\$	(22.1)
Fixed maturities, trading		63.1		60.7		2.4
Equity securities, available-for-sale		34.8		56.2		(21.4)
Derivative assets		62.4		100.7		(38.3)
Separate account assets		4,453.9		6,042.3		(1,588.4)
Liabilities						
Investment-type insurance contracts		(35.0)		(60.2)		25.2

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Derivative liabilities		(116.0)		(266.9)		150.9
Other liabilities		(97.6)		(103.8)		6.2
Net total	\$	5,516.5	\$	7,002.0	\$	(1,485.5)

The decrease in the fair value of Level 3 instruments for the nine months ended September 30, 2009, is primarily attributed to separate account assets. The decrease in separate account assets is primarily a result of unrealized losses on real estate. Unrealized losses on separate accounts do not impact net income in the consolidated statements of operations, as the change in value of separate account assets is offset by a change in value of separate account liabilities.

Table of Contents

The net change for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine months ended September 30, 2008, was as follows:

	Balance as of		Balance as of		Net change	
	September 30, 2008		January 1, 2008			
	(in millions)					
Assets						
Total fixed maturities, available-for-sale	\$	1,446.8	\$	2,201.3	\$	(754.5)
Fixed maturities, trading		71.2		92.3		(21.1)
Equity securities, available-for-sale		46.8		51.1		(4.3)
Derivative assets		75.9		54.3		21.6
Separate account assets		6,811.2		7,313.2		(502.0)
Liabilities						
Investment-type insurance contracts		7.0		(49.3)		56.3
Derivative liabilities		(151.8)		(62.3)		(89.5)
Other liabilities		(98.8)		(155.6)		56.8
Net total	\$	8,208.3	\$	9,445.0	\$	(1,236.7)

The decrease in the fair value of Level 3 instruments for the nine months ended September 30, 2008, is primarily attributed to the fixed maturities, available-for-sale securities and separate account assets. The decrease in fixed maturities, available-for-sale securities resulted from the settlement of certain credit collateralized debt obligations and unrealized losses recognized in other comprehensive income. Most of the unrealized losses related to corporate bonds, with lesser amounts attributed to collateralized debt obligations, asset-backed securities, and commercial mortgage-backed securities. The decrease in separate account assets is primarily a result of unrealized losses on real estate. Unrealized losses on separate accounts do not impact net income in the consolidated statements of operations as the change in value of separate account assets is offset by a change in value of separate account liabilities.

Investments

We had total consolidated assets as of September 30, 2009, of \$137.4 billion, of which \$63.6 billion were invested assets. The rest of our total consolidated assets are comprised primarily of separate account assets for which we do not bear investment risk. Because we generally do not bear any investment risk on assets held in separate accounts, the discussion and financial information below does not include such assets.

Overall Composition of Invested Assets

Invested assets as of September 30, 2009, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of invested assets are fixed maturity securities and commercial mortgage loans. The remainder is invested

in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets.

Table of Contents

	September 30, 2009		December 31, 2008	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Fixed maturity securities:				
Public	\$ 33,135.6	52%	\$ 28,786.7	49%
Private	13,577.8	21	12,173.9	21
Equity securities	397.2	1	400.7	1
Mortgage loans:				
Commercial	10,302.3	16	11,279.3	19
Residential	1,716.4	3	1,834.3	3
Real estate held for sale	31.0		139.6	
Real estate held for investment	993.9	2	779.8	1
Policy loans	899.6	1	896.4	1
Other investments	2,553.2	4	2,816.6	5
Total invested assets	63,607.0	100%	59,107.3	100%
Cash and cash equivalents	3,241.2		2,608.0	
Total invested assets and cash	\$ 66,848.2		\$ 61,715.3	

Investment Results

The following table presents the yield and investment income, excluding net realized capital gains and losses for our invested assets. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period.

	For the three months ended September 30,			
	Yield	2009	Yield	2008
		Amount		Amount
	(\$ in millions)			
Fixed maturity securities	6.0%	\$ 676.4	7.1%	\$ 826.1
Equity securities	4.7	4.6	3.8	4.6
Mortgage loans commercial	5.8	152.4	6.0	167.0
Mortgage loans residential	4.0	17.7	10.0	47.9
Real estate	3.3	8.3	6.7	14.9
Policy loans	7.1	16.0	6.7	14.7
Cash and cash equivalents	0.4	3.5	3.2	15.2
Other investments	(0.2)	(1.2)	4.6	24.4
Total before investment expenses	5.3	877.7	6.7	1,114.8
Investment expenses	0.1	(24.4)	0.2	(35.1)
Net investment income	5.2%	\$ 853.3	6.5%	\$ 1,079.7

Table of Contents

	For the nine months ended September 30,					
	Yield	2009	Amount	Yield	2008	Amount
		(\$ in millions)				
Fixed maturity securities	6.2%	\$	2,034.2	6.7%	\$	2,330.8
Equity securities	4.7		14.0	3.5		13.7
Mortgage loans commercial	5.8		469.3	6.0		500.4
Mortgage loans residential	3.6		48.3	8.4		120.6
Real estate	3.7		26.8	6.9		45.3
Policy loans	6.8		46.3	6.6		43.6
Cash and cash equivalents	0.5		10.4	3.3		44.2
Other investments	(1.2)		(23.5)	2.6		40.1
Total before investment expenses	5.4		2,625.8	6.4		3,138.7
Investment expenses	0.1		(83.9)	0.2		(107.8)
Net investment income	5.3%	\$	2,541.9	6.2%	\$	3,030.9

The following tables present the contributors to net realized capital gains and losses for our invested assets for the three months ended September 30, 2009 and 2008.

	For the three months ended September 30, 2009							
	Impairments and credit losses		Other gains (losses)		Hedging adjustments		Net realized capital gains (losses)	
	(in millions)							
Fixed maturity securities (1)	\$	(107.2)	\$	41.4	\$	68.3	\$	2.5
Fixed maturity securities, trading				15.7				15.7
Equity securities (2)		(9.5)		0.4				(9.1)
Equity securities, trading				19.2				19.2
Mortgage loans on real estate (3)		(39.2)						(39.2)
Derivatives (4)						(64.5)		(64.5)
Other (5)				6.8		2.0		8.8
Total	\$	(155.9)	\$	83.5	\$	5.8	\$	(66.6)

(1) Impairments and credit losses include \$153.7 million of other-than-temporary impairments, of which \$45.3 million of noncredit impairment losses have been reclassified and recognized in other comprehensive income, and \$1.2 million in realized credit recoveries on the sale of previously impaired assets. The hedging adjustments include \$0.5 million of impairment-related losses. Therefore, total net impairment losses for fixed maturity securities available-for-sale were \$107.7 million.

(2) Impairments include \$21.7 million of impairment write-downs and \$12.2 million in realized credit recoveries on previously impaired assets.

(3) Impairments include \$18.9 million in realized losses on permanent impairments of commercial mortgage loans and foreclosures, a \$10.6 million increase in the commercial mortgage valuation allowance, and a \$4.7

million increase in the residential mortgage valuation allowance.

(4) Derivatives include \$80.8 million of net losses related to derivatives used in qualifying hedges of fixed maturity securities and \$25.4 million of net losses related to derivatives used in qualifying hedges of liabilities. Partially offsetting these net losses is a net gain from mark-to-market adjustments on derivatives not designated as hedging instruments, with the largest components being \$41.0 million of net gains on interest rate contracts, \$16.1 million of net losses on equity contracts, \$12.6 million of net gains on credit default swaps and the remainder relating to net gains from other risk management activities.

(5) Other gains (losses) include net gains on certain seed money investments. Hedging adjustments primarily include net gains on certain liabilities in fair value hedging relationships.

Table of Contents

	For the three months ended September 30, 2008							
	Impairments and credit losses		Other gains (losses)		Hedging adjustments		Net realized capital gains (losses)	
	(in millions)							
Fixed maturity securities (1)	\$	(175.5)	\$	9.2	\$	47.5	\$	(118.8)
Fixed maturity securities, trading				(18.6)				(18.6)
Equity securities (2)		(21.1)						(21.1)
Equity securities, trading				(8.4)				(8.4)
Mortgage loans on real estate (3)		(1.9)						(1.9)
Derivatives (4)						(82.7)		(82.7)
Other (5)		(7.3)		(26.6)		54.8		20.9
Total	\$	(205.8)	\$	(44.4)	\$	19.6	\$	(230.6)

(1) Impairments and credit losses include \$176.4 million of other-than-temporary impairments and \$0.9 million in realized credit recoveries on the sale of previously impaired assets. The hedging adjustments include \$13.1 million of impairment-related losses. Therefore, total net impairment losses for fixed maturity securities available-for-sale were \$188.6 million.

(2) Impairments include \$21.1 million of impairment write-downs.

(3) Impairments include \$10.4 million in realized losses due to the foreclosure of a commercial mortgage loan, an \$8.7 million decrease in the commercial mortgage valuation allowance, and a \$0.2 million increase in the residential mortgage valuation allowance held by our international operations.

(4) Derivatives include \$41.5 million of net losses related to derivatives used in qualifying hedges of fixed maturity securities and \$85.0 million of net losses related to derivatives used in qualifying hedges of liabilities. Partially offsetting these losses is a gain from mark-to-market adjustments on derivatives not designated as hedging instruments, with the largest components being \$31.6 million of net gains on interest rate contracts and \$6.6 million of net gains on equity contracts, with the remainder relating to net gains from other risk management activities.

(5) Impairments include \$7.3 million in realized losses on the investment in a money market mutual fund. Other gains (losses) include net losses on certain seed money investments. Hedging adjustments primarily include net gains on certain liabilities in fair value hedging relationships.

The following tables present the contributors to net realized capital gains and losses for our invested assets for the nine months ended September 30, 2009 and 2008.

	For the nine months ended September 30, 2009							
	Impairments and credit losses		Other gains (losses)		Hedging adjustments		Net realized capital gains (losses)	
	(in millions)							
Fixed maturity securities (1)	\$	(333.6)	\$	98.1	\$	(165.3)	\$	(400.8)
Fixed maturity securities, trading				57.5				57.5
Equity securities (2)		(11.2)		0.5				(10.7)
Equity securities, trading				29.9				29.9
Mortgage loans on real estate (3)		(115.8)						(115.8)
Derivatives (4)						197.6		197.6
Other (5)				16.8		(59.6)		(42.8)
Total	\$	(460.6)	\$	202.8	\$	(27.3)	\$	(285.1)

(1) Impairments and credit losses include \$501.2 million of other-than-temporary impairments, of which \$162.4 million of noncredit impairment losses have been reclassified and recognized in other comprehensive income, and \$5.2 million in realized credit recoveries on the sale of previously impaired assets. The hedging adjustments include \$2.8 million of impairment-related net losses. Therefore, total net impairment losses for fixed maturity securities available-for-sale were \$336.4 million.

Table of Contents

(2) Impairments include \$35.5 million of impairment write-downs and \$24.3 million in realized credit recoveries on previously impaired assets.

(3) Impairments include a \$50.5 million increase in the commercial mortgage valuation allowance, \$29.9 million in realized losses on foreclosures and permanent impairments of commercial mortgage loans, and a \$27.0 million increase in the residential mortgage valuation allowance.

(4) Derivatives include \$174.4 million of net gains related to derivatives used in qualifying hedges of fixed maturity securities and \$65.3 million of net gains related to derivatives used in qualifying hedges of liabilities. Partially offsetting these net gains is a net loss from mark-to-market adjustments on derivatives not designated as hedging instruments, with the largest components being \$84.6 million of net losses on equity contracts, \$60.9 million of net gains on credit default swaps, \$54.1 million of net losses on interest rate contracts and the remainder relating to net gains from other risk management activities.

(5) Other gains (losses) include net gains on certain seed money investments. Hedging adjustments primarily include net losses on certain liabilities in fair value hedging relationships.

	For the nine months ended September 30, 2008				Net realized capital gains (losses)
	Impairments and credit losses	Other gains (losses)	Hedging adjustments		
	(in millions)				
Fixed maturity securities (1)	\$ (253.7)	\$ 16.6	\$ 35.8	\$ (201.3)	
Fixed maturity securities, trading		(41.2)		(41.2)	
Equity securities (2)	(56.3)	2.0		(54.3)	
Equity securities, trading		(19.9)		(19.9)	
Mortgage loans on real estate (3)	(15.1)			(15.1)	
Derivatives (4)			(221.8)	(221.8)	
Other (5)	(7.3)	(24.6)	117.4	85.5	
Total	\$ (332.4)	\$ (67.1)	\$ (68.6)	\$ (468.1)	

(1) Impairments and credit losses include \$261.1 million of other-than-temporary impairments and \$7.4 million in realized credit recoveries on the sale of previously impaired assets. The hedging adjustments include \$13.1 million of impairment-related losses. Therefore, total net impairment losses for fixed maturity securities available-for-sale were \$266.8 million.

(2) Impairments include \$56.3 million of impairment write-downs.

(3) Impairments include \$16.4 million in realized losses due to the foreclosure of commercial mortgage loans, a \$1.6 million decrease in the commercial mortgage valuation allowance, and a \$0.3 million increase in the residential mortgage valuation allowance held by our international operations.

(4) Derivatives include \$29.9 million of net losses related to derivatives used in qualifying hedges of fixed maturity securities and \$147.5 million of net losses related to derivatives used in qualifying hedges of liabilities. The remainder of the net loss resulted primarily from mark-to-market adjustments on derivatives not designated as hedging instruments, with the largest components being \$58.2 million of net losses on credit default swaps and \$6.9 million of net losses on interest rate contracts, with the remainder relating to net gains from other risk management activities.

(5) Impairments include \$7.3 million in realized losses on the investment in a money market mutual fund. Other gains (losses) include net losses on certain seed money investments. Hedging adjustments primarily include net gains on certain liabilities in fair value hedging relationships.

Table of Contents

U.S. Investment Operations

Of our invested assets, \$59.5 billion were held by our U.S. operations as of September 30, 2009. Our U.S. invested assets are managed primarily by Principal Global Investors. Our primary investment objective is to maximize after-tax returns consistent within acceptable risk parameters. We seek to protect policyholders' benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing the credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification. We are exposed to three primary sources of investment risk:

- credit risk, relating to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest;
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves and
- equity risk, relating to adverse fluctuations in a particular common stock, which we have limited exposure to in our portfolio.

Our ability to manage credit risk is essential to our business and our profitability. We devote considerable resources to the credit analysis of each new investment. We manage credit risk through industry, issuer and asset class diversification. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing all investment policies and approving or authorizing all investments, except the Executive Committee of the Board must approve any investment transaction exceeding \$500.0 million. As of September 30, 2009, there are nine members on the Investment Committee, one of whom is a member of our Board of Directors. The remaining members are senior management members representing various areas of our company.

We also seek to reduce call or prepayment risk arising from changes in interest rates in individual investments. We limit our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer and we require additional yield on these investments to compensate for the risk that the issuer will exercise such option. We assess option risk in all investments we make and, when we take that risk, we price for it accordingly.

Our Fixed Income Securities Committee, consisting of fixed income securities senior management members, approves the credit rating for the fixed maturity securities we purchase. Teams of security analysts, organized by industry, analyze and monitor these investments. In addition, we have teams who specialize in residential mortgage-backed securities, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS) and public below investment grade securities. We establish a credit reviewed list of approved public issuers to provide an efficient way for our portfolio managers to purchase liquid bonds for which credit review has already been completed. Issuers remain on the list for one year unless removed by our analysts. Our analysts monitor issuers on the list on a continuous basis with a formal review documented annually or more frequently if material events affect the issuer. The analysis includes both fundamental and technical factors. The fundamental analysis encompasses both quantitative and qualitative analysis of the issuer. The qualitative analysis includes an assessment of both accounting and management aggressiveness of the issuer. In addition, technical indicators such as stock price volatility and credit default swap levels are monitored.

Our Fixed Income Securities Committee also reviews private transactions on a continuous basis to assess the quality ratings of our privately placed investments. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

- material declines in the issuer's revenues or margins;
- significant management or organizational changes;
- significant uncertainty regarding the issuer's industry;
- debt service coverage or cash flow ratios that fall below industry-specific thresholds;
- violation of financial covenants and

Table of Contents

- other business factors that relate to the issuer.

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage loan portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering the origination of new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying security, conduct a comprehensive market analysis and compare against industry lending practices. We use a proprietary risk rating model to evaluate all new and a majority of existing loans within the portfolio. The proprietary risk model is designed to stress projected cash flows under simulated economic and market downturns. Our lending guidelines are designed to encourage 75% or less loan-to-value ratios and a debt service coverage ratio of at least 1.2 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The weighted average loan-to-value ratio at origination for new brick and mortar commercial mortgages in our portfolio was 49% and 59% as of September 30, 2009 and December 31, 2008, respectively. The debt service coverage ratio at loan inception for new brick and mortar commercial mortgages in our portfolio was 2.2 and 1.7 times as of September 30, 2009 and December 31, 2008, respectively. There have only been two new origination loans during 2009. The weighted average loan-to-value ratio for loans held in our brick and mortar commercial mortgage portfolio as of September 30, 2009 and December 31, 2008, was 67% and 62% respectively. The debt service coverage ratio for loans held in our brick and mortar commercial mortgage portfolio as of September 30, 2009 and December 31, 2008 was 1.8 times for both time periods.

Our investment decisions and objectives are a function of the underlying risks and product profiles of each primary business operation. In addition, we diversify our product portfolio offerings to include products that contain features that will protect us against fluctuations in interest rates. Those features include adjustable crediting rates, policy surrender charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk.

Overall Composition of U.S. Invested Assets

U.S. invested assets as of September 30, 2009, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of U.S. invested assets are fixed maturity securities and commercial mortgage loans. The remainder is invested in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets. The following discussion analyzes the composition of U.S. invested assets, but excludes invested assets of the separate accounts.

Table of Contents

	September 30, 2009		December 31, 2008	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Fixed maturity securities:				
Public	\$ 30,562.4	51%	\$ 26,652.5	48%
Private	13,577.8	23	12,173.9	22
Equity securities	353.8	1	359.9	1
Mortgage loans:				
Commercial	10,302.3	17	11,279.3	20
Residential	1,173.2	2	1,354.4	2
Real estate held for sale	18.9		135.4	
Real estate held for investment	993.9	2	779.8	1
Policy loans	880.6	1	881.4	2
Other investments	1,682.6	3	2,162.4	4
Total invested assets	59,545.5	100%	55,779.0	100%
Cash and cash equivalents	3,206.4		2,537.0	
Total invested assets and cash	\$ 62,751.9		\$ 58,316.0	

Fixed Maturity Securities

Fixed maturity securities consist of publicly traded and privately placed bonds, mortgage-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. Included in the privately placed category as of September 30, 2009 and December 31, 2008, were \$7.4 billion and \$6.2 billion, respectively, of securities subject to certain holding periods and resale restrictions pursuant to Rule 144A of the Securities Act of 1933.

Fixed maturity securities were diversified by category of issuer as of September 30, 2009 and December 31, 2008, as shown in the following table:

	September 30, 2009		December 31, 2008	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
U.S. Government and agencies	\$ 763.0	2%	\$ 595.2	1%
States and political subdivisions	2,132.1	5	2,176.7	6
Non-U.S. governments	466.7	1	478.5	1
Corporate public	19,014.5	43	17,224.9	44
Corporate private	11,586.4	26	10,365.4	27
Residential pass-through securities	3,292.3	8	2,187.9	6
Commercial mortgage-backed securities	3,740.8	8	3,607.1	9
Residential collateralized mortgage obligations	1,013.5	2	768.6	2
Asset-backed securities	2,130.9	5	1,422.1	4
Total fixed maturity securities	\$ 44,140.2	100%	\$ 38,826.4	100%

We believe that it is desirable to hold residential mortgage-backed pass-through securities due to their credit quality and liquidity as well as portfolio diversification characteristics. Our portfolio is comprised of Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation pass-through securities. In addition, our residential collateralized mortgage obligation portfolio offers structural features that allow cash flows to be matched to our liabilities.

CMBS provide varying levels of credit protection, diversification and reduced event risk depending on the securities owned and composition of the loan pool. CMBS are predominantly comprised of large pool securitizations that are diverse by property type, borrower and geographic dispersion. The risks to any CMBS deal are determined by the credit quality of the underlying loans and how those loans perform over time. Another key risk is the vintage of the underlying loans and the state of the markets during a particular vintage. In the CMBS market, there is a material difference in the outlook for the performance of loans originated in 2005 and earlier relative to loans originated in 2006 through 2008. For loans originated prior to 2006, underwriting assumptions were more conservative regarding required debt service coverage and loan-to-value ratios. For the

Table of Contents

2006 through 2008 vintages, real estate values peaked and the underwriting expectations were that values would continue to increase which makes those loan values more sensitive to market declines.

We purchase ABS to diversify the overall credit risks of the fixed maturity securities portfolio and to provide attractive returns. The principal risks in holding ABS are structural and credit risks. Structural risks include the security's priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from the collateral and the potential for prepayments. Credit risks involve issuer/servicer risk where collateral values can become impaired in the event of servicer credit deterioration. Our ABS portfolio is diversified both by type of asset and by issuer. We actively monitor holdings of ABS to ensure that the risk profile of each security improves or remains consistent. Prepayments in the ABS portfolio are, in general, insensitive to changes in interest rates or are insulated from such changes by call protection features. In the event that we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we diversify the risks of ABS by holding a diverse class of securities, which limits our exposure to any one security.

The international exposure held in our U.S. operation's fixed maturity securities portfolio totaled \$9,558.0 million, or 22%, and \$8,178.3 million, or 21%, of total fixed maturity securities, as of September 30, 2009 and December 31, 2008, respectively. It is comprised of corporate and foreign government fixed maturity securities. The following table presents our international exposure for our U.S. operation's fixed maturity securities portfolio for the periods indicated.

	September 30, 2009 Carrying amount	December 31, 2008 Carrying amount
	(in millions)	
European Union	\$ 2,937.5	\$ 2,432.9
United Kingdom	2,259.3	2,049.5
Asia	1,052.1	973.3
Australia	1,029.0	743.5
South America	513.9	500.8
Mexico	233.7	264.9
Japan	54.9	50.8
Other countries (1)	1,477.6	1,162.6
Total	\$ 9,558.0	\$ 8,178.3

(1) Includes exposure from 23 countries as of September 30, 2009 and 24 countries as of December 31, 2008.

All international fixed maturity securities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturity securities investments to 20% of total statutory general account assets with a 4% limit in emerging markets. Exposure to Canada is not included in our international exposure. As of September 30, 2009 and December 31, 2008, our investments in Canada totaled \$1,559.7 million and \$1,402.2 million, respectively.

Fixed Maturity Securities Credit Concentrations. One aspect of managing credit risk is through industry issuer and asset class diversification. Our credit concentrations are managed to established limits. The exposure attributed to monoline bond and mortgage insurers from investments that are guaranteed by them is not included in the evaluation of our top ten exposures. We are not relying on said guarantors and are directly evaluating exposure to these investments. The following table presents our top ten exposures as of September 30, 2009.

Table of Contents

	Amortized cost (in millions)
Bank of America Corp. (1)	\$ 332.8
JP Morgan Chase & Co. (1)	318.1
General Electric Co.	246.9
Wells Fargo & Co. (1)	246.0
AT&T Inc.	236.0
Lloyds Banking Group PLC	198.1
Verizon Communications Inc.	170.9
Credit Suisse Group AG (1)	150.4
Prudential Financial Inc.	147.0
ConocoPhillips	140.8
Total top ten exposures	\$ 2,187.0

- (1) Includes actual counterparty exposure.

We have exposure to monoline bond and mortgage insurers with an amortized cost of \$729.7 million and a carrying amount of \$701.2 million as of September 30, 2009. The \$729.7 million includes wrapped guarantees on \$694.5 million of underlying municipal bonds, corporate credit or ABS. Our direct exposure to these insurers was \$35.2 million. Of the \$694.5 million in wrapped guarantees, 44% was municipal bonds, of which 99% was investment grade; 40% was investment grade bank perpetual preferred securities; 10% was ABS backed by sub-prime first lien mortgages, of which 35% was investment grade; and 6% was corporate fixed maturities, of which 92% was investment grade.

Fixed Maturity Securities Valuation and Credit Quality. Valuation techniques for the fixed maturity securities portfolio vary by security type and the availability of market data. The use of different pricing techniques and their assumptions could produce different financial results. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Fair Value of Financial Instruments, for further details regarding our pricing methodology. Once prices are determined, they are reviewed by pricing analysts for reasonableness based on asset class and observable market data. In addition, investment analysts who are familiar with specific securities review prices for reasonableness through direct interaction with external sources, review of recent trade activity or use of internal models. Monthly, all bonds placed on the watch list are analyzed by investment analysts or analysts that focus on troubled securities (Workout Group). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative and unobservable inputs.

The Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC) evaluates the bond investments of insurers for regulatory reporting purposes and assigns securities to one of six investment categories. The NAIC designations closely mirror the NRSROs credit ratings for marketable bonds. NAIC designations 1 and 2 include bonds considered investment grade by such rating organizations. Bonds are considered investment grade when rated Baa3 or higher by Moody s, or BBB- or higher by Standard & Poor s. NAIC designations 3 through 6 are referred to as below investment grade. Bonds are considered below investment grade when rated Ba1 or lower by Moody s, or BB+ or lower by Standard & Poor s. As of September 30, 2009, the percentage, based on fair value, of total publicly traded and privately placed fixed maturity securities that were investment grade with an NAIC designation 1 or 2 was 92%.

Table of Contents

The following table presents our total fixed maturity securities by NAIC designation and the equivalent ratings of the NRSROs as of September 30, 2009 and December 31, 2008, as well as the percentage, based on fair value, that each designation comprises:

NAIC rating	Rating agency equivalent	September 30, 2009			December 31, 2008		
		Amortized cost	Carrying amount	% of total carrying amount	Amortized cost	Carrying amount	% of total carrying amount
(\$ in millions)							
1	Aaa/Aa/A	\$ 24,796.9	\$ 24,639.7	56%	\$ 25,981.0	\$ 22,116.9	57%
2	Baa	16,416.3	16,096.9	36	17,669.2	14,675.2	38
3	Ba	2,510.0	2,055.9	5	2,469.8	1,760.6	5
4	B	1,463.8	893.4	2	254.2	163.9	
5	Caa and lower	519.1	324.7	1	109.7	62.3	
6	In or near default	239.5	129.6		71.2	47.5	
	Total fixed maturity securities	\$ 45,945.6	\$ 44,140.2	100%	\$ 46,555.1	\$ 38,826.4	100%

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Fixed maturity securities include 33 securities with an amortized cost of \$346.3 million, gross gains of \$16.1 million, gross losses of \$6.9 million and a carrying amount of \$355.5 million as of September 30, 2009, that are still pending a review and assignment of a rating by the SVO. Due to the timing of when fixed maturity securities are purchased, legal documents are filed and the review by the SVO is completed, there will always be securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent rating is assigned based on our fixed income analyst's assessment.

Commercial Mortgage-Backed Securities and Home Equity Asset-Backed Securities Portfolios. As of September 30, 2009, based on amortized cost, 70% of our CMBS portfolio had ratings of A or higher and 57% was issued in 2005 or before and 50% of our ABS home equity portfolio had ratings of A or higher and 85% was issued in 2005 or before.

The following table presents credit quality and year of issuance (vintage) for our CMBS:

	September 30, 2009		December 31, 2008	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount
(in millions)				
Lowest agency rating				
AAA	\$ 2,504.2	\$ 2,361.4	\$ 3,558.3	\$ 2,757.0
AA	461.5	368.1	812.7	373.4
A	633.5	430.1	673.0	270.8
BBB	679.7	349.9	555.3	179.7
BB and below	830.3	231.3	86.0	26.2
Total by lowest agency rating	\$ 5,109.2	\$ 3,740.8	\$ 5,685.3	\$ 3,607.1
Vintage				
2003 and prior	\$ 1,521.1	\$ 1,383.0	\$ 1,888.6	\$ 1,587.2
2004	545.0	431.6	586.3	393.5
2005	843.2	612.1	913.6	547.9
2006 (1)	532.7	325.8	563.4	282.8
2007 (1)	1,576.6	933.9	1,642.3	750.4
2008	90.6	54.4	91.1	45.3
Total by vintage	\$ 5,109.2	\$ 3,740.8	\$ 5,685.3	\$ 3,607.1

(1) As of September 30, 2009, 42% of the 2006 vintage are rated AAA and 4% are rated AA, and 38% of the 2007 vintage are rated AAA and 3% are rated AA.

Table of Contents

The following table presents our exposure to ABS home equity portfolio supported by subprime first lien mortgages by credit quality and vintage:

	September 30, 2009		December 31, 2008	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount
(in millions)				
Lowest agency rating				
AAA	\$ 143.0	\$ 109.8	\$ 281.8	\$ 201.5
AA	95.1	57.2	94.0	56.0
A	14.6	10.8	47.6	28.2
BBB	54.5	33.8	89.3	43.8
BB and below	200.2	99.3	32.4	17.2
Total by lowest agency rating	\$ 507.4	\$ 310.9	\$ 545.1	\$ 346.7
Vintage				
2003 and prior	\$ 246.1	\$ 165.9	\$ 270.2	\$ 197.9
2004	84.0	59.4	91.1	53.7
2005	99.8	49.3	101.8	54.9
2006	18.6	6.9	18.8	10.3
2007	58.9	29.4	63.2	29.9
Total by vintage	\$ 507.4	\$ 310.9	\$ 545.1	\$ 346.7

Fixed Maturity Securities Watch List. We monitor any decline in the credit quality of fixed maturity securities through the designation of problem securities, potential problem securities and restructured securities. We define problem securities in our fixed maturity portfolio as securities: (i) as to which principal and/or interest payments are in default or where default is perceived to be imminent in the near term, or (ii) issued by a company that went into bankruptcy subsequent to the acquisition of such securities. We define potential problem securities in our fixed maturity portfolio as securities included on an internal watch list for which management has concerns as to the ability of the issuer to comply with the present debt payment terms and which may result in the security becoming a problem or being restructured. The decision whether to classify a performing fixed maturity security as a potential problem involves significant subjective judgments by our management as to the likely future industry conditions and developments with respect to the issuer. We define restructured securities in our fixed maturity portfolio as securities where a concession has been granted to the borrower related to the borrower's financial difficulties that would not have otherwise been considered. We determine that restructures should occur in those instances where greater economic value will be realized under the new terms than through liquidation or other disposition and may involve a change in contractual cash flows. If, at the time of restructure, the present value of the new future cash flows is less than the current cost of the asset being restructured, a realized capital loss is recorded in net income and a new cost basis is established.

The following table presents the total carrying amount of our fixed maturity securities portfolio, as well as its problem, potential problem and restructured fixed maturities for the periods indicated:

	September 30, 2009	December 31, 2008
(\$ in millions)		
Total fixed maturity securities (public and private)	\$ 44,140.2	\$ 38,826.4
Problem fixed maturity securities (1)	\$ 206.1	\$ 83.3
Potential problem fixed maturity securities	381.9	165.7
Restructured fixed maturity securities		3.1
Total problem, potential problem and restructured fixed maturity securities	\$ 588.0	\$ 252.1
Total problem, potential problem and restructured fixed maturity securities as a percent of total fixed maturity securities	1.33%	.65%

(1) The problem fixed maturity securities carrying amount is net of other-than-temporary impairment losses.

Table of Contents

Fixed Maturity Securities Impairments. We have a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers' credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Every month, a group of individuals including the Chief Investment Officer, our Portfolio Managers, members of our Workout Group and representatives from Investment Accounting review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. The analysis focuses on each issuer's ability to service its debts in a timely fashion. Formal documentation of the analysis and our decision is prepared and approved by management.

We consider relevant facts and circumstances in evaluating whether a credit or interest-rate related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) our intent to sell the security or whether it is more likely than not we will be required to sell the security before recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized. For additional details, see Item 1 Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 2, Investments.

When it is not our intent to sell a security with unrealized losses, it is not more likely than not that we would be required to sell the security before recovery of the amortized cost, which may be maturity, and we expect to recover the amortized cost basis, we would not consider the security to be other-than-temporarily impaired. However, we do sell bonds under certain circumstances, such as when we have evidence of a significant deterioration in the issuer's creditworthiness, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities. Sales generate both gains and losses.

There are a number of significant risks and uncertainties inherent in the process of monitoring credit impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to not sell the security prior to recovery of its amortized cost. Any of these situations could result in a charge to net income in a future period.

The net realized loss relating to other-than-temporary credit impairments of fixed maturity securities was \$333.0 million and \$252.8 million for the nine months ended September 30, 2009 and 2008, respectively.

Table of Contents

Fixed Maturity Securities Available-for-Sale

The following tables present our fixed maturity securities available-for-sale by industry category and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in OCI, as of September 30, 2009 and December 31, 2008.

	September 30, 2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance Banking	\$ 4,458.4	\$ 71.1	\$ 611.7	\$ 3,917.8
Finance Brokerage	399.8	12.1	7.9	404.0
Finance Finance Companies	290.8	8.8	22.6	277.0
Finance Financial Other	546.5	31.2	14.5	563.2
Finance Insurance	2,767.0	51.4	262.1	2,556.3
Finance REITS	1,369.0	8.9	108.8	1,269.1
Industrial Basic Industry	1,912.0	79.1	35.2	1,955.9
Industrial Capital Goods	2,209.1	90.2	44.9	2,254.4
Industrial Communications	2,791.1	189.7	31.3	2,949.5
Industrial Consumer Cyclical	1,577.5	58.8	47.9	1,588.4
Industrial Consumer Non-Cyclical	3,182.3	195.1	53.0	3,324.4
Industrial Energy	1,941.2	113.2	22.3	2,032.1
Industrial Other	675.2	23.6	19.9	678.9
Industrial Technology	843.3	33.9	18.8	858.4
Industrial Transportation	926.7	47.2	30.2	943.7
Utility Electric	2,550.5	141.5	21.6	2,670.4
Utility Natural Gas	991.6	65.0	7.1	1,049.5
Utility Other	138.1	10.5	0.8	147.8
FDIC guaranteed	95.9	1.6		97.5
Government guaranteed	985.5	84.3	7.2	1,062.6
Total corporate securities	30,651.5	1,317.2	1,367.8	30,600.9
Residential pass-through securities	2,912.9	91.1	1.0	3,003.0
Commercial mortgage-backed securities	5,105.8	20.8	1,389.2	3,737.4
Residential collateralized mortgage obligations (1)	1,065.3	15.5	124.4	956.4
Asset-backed securities Home equity (2)	507.4		196.5	310.9
Asset-backed securities All other	1,381.5	20.5	13.8	1,388.2
Collateralized debt obligations Credit	197.1	0.8	77.4	120.5
Collateralized debt obligations CMBS	252.9		146.5	106.4
Collateralized debt obligations Loans	103.2		32.3	70.9
Collateralized debt obligations ABS (3)	53.8	0.2	26.2	27.8
Total mortgage-backed and other asset-backed securities	11,579.9	148.9	2,007.3	9,721.5
U.S. Government and agencies	525.0	11.1	0.1	536.0

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

States and political subdivisions		1,909.3		64.1		13.6		1,959.8
Non-U.S. governments		424.6		43.6		1.5		466.7
Total fixed maturity securities, available-for-sale	\$	45,090.3	\$	1,584.9	\$	3,390.3	\$	43,284.9

(1) Includes exposure to Alt-a mortgage loans with an amortized cost of \$62.7 million, gross unrealized gains of \$0.1 million, gross unrealized losses of \$18.1 million, and a carrying amount of \$44.7 million. The Alt-a portfolio has a weighted average rating of BBB and 65% are 2005 and prior vintages.

(2) This exposure is all related to sub-prime mortgage loans.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Table of Contents

(3) Includes exposure to sub-prime mortgage loans with an amortized cost of \$29.3 million, gross unrealized gains of \$0.2 million, gross unrealized losses of \$22.0 million, and a carrying amount of \$7.5 million.

		December 31, 2008			
		Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
		(in millions)			
Finance	Banking	\$ 4,248.7	\$ 14.9	\$ 1,095.1	\$ 3,168.5
Finance	Brokerage	785.4	0.9	128.5	657.8
Finance	Finance Companies	418.6	0.1	84.7	334.0
Finance	Financial Other	753.3	6.8	104.6	655.5
Finance	Insurance	2,885.8	38.1	706.6	2,217.3
Finance	REITS	1,412.5		430.6	981.9
Industrial	Basic Industry	2,030.0	10.6	303.8	1,736.8
Industrial	Capital Goods	2,322.3	15.1	316.8	2,020.6
Industrial	Communications	2,943.7	32.3	297.0	2,679.0
Industrial	Consumer Cyclical	2,023.8	18.7	338.7	1,703.8
Industrial	Consumer Non-Cyclical	3,184.7	31.2	298.5	2,917.4
Industrial	Energy	1,958.0	9.6	224.5	1,743.1
Industrial	Other	952.8	2.4	117.6	837.6
Industrial	Technology	876.7	2.2	115.3	763.6
Industrial	Transportation	992.2	10.3	124.5	878.0
Utility	Electric	2,473.4	22.8	199.2	2,297.0
Utility	Natural Gas	1,142.0	4.9	110.7	1,036.2
Utility	Other	156.7	2.3	14.3	144.7
Government guaranteed		799.5	75.0	57.0	817.5
Total corporate securities		32,360.1	298.2	5,068.0	27,590.3
Residential pass-through securities		1,627.5	50.5	0.5	1,677.5
Commercial mortgage-backed securities		5,682.7	3.7	2,081.9	3,604.5
Residential collateralized mortgage obligations (1)		950.8	6.4	188.6	768.6
Asset-backed securities	Home equity (2)	545.1	0.1	198.5	346.7
Asset-backed securities	All other	816.1	16.8	137.2	695.7
Collateralized debt obligations	Credit	202.8		123.6	79.2
Collateralized debt obligations	CMBS	302.2		173.3	128.9
Collateralized debt obligations	Loans	91.4		54.4	37.0
Collateralized debt obligations	ABS (3)	100.0	0.2	53.5	46.7
Total mortgage-backed and other asset-backed securities		10,318.6	77.7	3,011.5	7,384.8
U.S. Government and agencies		548.4	46.9	0.1	595.2
States and political subdivisions		2,113.8	32.6	120.9	2,025.5
Non-U.S. governments		462.1	31.5	15.1	478.5
Total fixed maturity securities, available-for-sale		\$ 45,803.0	\$ 486.9	\$ 8,215.6	\$ 38,074.3

(1) Includes exposure to Alt-a mortgage loans with an amortized cost of \$67.3 million, gross unrealized losses of \$17.3 million and a carrying amount of \$50.0 million. The Alt-a portfolio has a weighted average rating of AA and 66% are 2005 and prior vintages.

(2) This exposure is all related to sub-prime mortgage loans.

(3) Includes exposure to sub-prime mortgage loans with an amortized cost of \$66.4 million, gross unrealized gains of \$0.1 million, gross unrealized losses of \$46.6 million and a carrying amount of \$19.9 million.

Table of Contents

Of the \$3,390.3 million in gross unrealized losses as of September 30, 2009, there were \$21.3 million in losses attributed to securities scheduled to mature in one year or less, \$194.1 million attributed to securities scheduled to mature between one to five years, \$289.3 million attributed to securities scheduled to mature between five to ten years, \$878.3 million attributed to securities scheduled to mature after ten years and \$2,007.3 million related to mortgage-backed and other ABS that are not classified by maturity year.

Of the \$5,923.3 million decrease in net unrealized losses for the nine months ended September 30, 2009, an approximate \$1.3 billion net unrealized loss can be attributed to an approximate 67 basis points increase in market rates and is more than offset by net unrealized gains related to other market factors. Of the \$7,781.8 million increase in net unrealized losses for the year ended December 31, 2008, an approximate \$3.1 billion net unrealized gain can be attributed to an approximate 210 basis points decrease in market rates and is more than offset by net unrealized losses related to other market factors.

Credit Disruption. The credit disruption in the market that began in the last half of 2007 from concerns in the sub-prime markets, and continued into 2008 and 2009 with concerns in the leveraged finance markets has led to reduced liquidity and wider credit spreads. These credit concerns led to widespread forced selling into a very thinly traded market which further strained market liquidity. This market disruption lowered valuations and, as a result, we have seen an increase in unrealized losses in our securities portfolio. The losses were more pronounced in the Finance sectors and in structured products such as collateralized debt obligations, ABS and CMBS. The decline in value in large part reflects the illiquid markets. During the second and third quarters of 2009, a narrowing of credit spreads and some improvement in liquidity resulted in a decrease in the unrealized losses in our securities portfolio. Future changes in the fair value of these securities will be dependent on continued improvement in market liquidity and changes in general market conditions, including interest rates and credit spread movements. We concluded the prices of the securities in our securities portfolio were temporarily depressed due to (1) the issuers' continued satisfaction of the securities obligations in accordance with their contractual terms, (2) the expectation the issuers will continue to satisfy their obligations given the evaluation of the fundamentals of the issuers' financial condition and other objective evidence and (3) management not having the intent to sell these securities and as it is not more likely than not that we would be required to sell these securities before the recovery of the amortized cost.

Fixed Maturity Available-for-Sale Securities Unrealized Losses. We believe that our long-term fixed maturity securities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturity securities. The net cash inflows into investment grade fixed maturity securities are less than prior years due to us investing in more liquid investments. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of cash flow. As of September 30, 2009, we had invested 0.1% of new cash flow for the year in below investment grade assets. While the general account investment returns have improved due to the below investment grade asset class, we manage its growth strategically by limiting it to no more than 10% of the total fixed maturity securities portfolios.

We invest in privately placed fixed maturity securities to enhance the overall value of the portfolio, increase diversification and obtain higher yields than are possible with comparable quality public market securities. Generally, private placements provide broader access to management information, strengthened negotiated protective covenants, call protection features and, where applicable, a higher level of collateral. They are, however, generally not freely tradable because of restrictions imposed by federal and state securities laws and illiquid trading markets.

The following table presents our fixed maturity securities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in OCI, for the time periods indicated.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Table of Contents

	September 30, 2009				December 31, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)							
Investment grade:								
Public	\$ 28,019.8	\$ 1,071.5	\$ 1,135.6	\$ 27,955.7	\$ 28,981.9	\$ 308.3	\$ 4,253.1	\$ 25,037.1
Private	12,350.4	467.2	879.7	11,937.9	13,916.2	175.9	3,089.2	11,002.9
Below investment grade:								
Public	2,380.7	15.7	559.4	1,837.0	1,319.4	1.6	385.5	935.5
Private	2,339.4	30.5	815.6	1,554.3	1,585.5	1.1	487.8	1,098.8
Total fixed maturity securities, available-for-sale	\$ 45,090.3	\$ 1,584.9	\$ 3,390.3	\$ 43,284.9	\$ 45,803.0	\$ 486.9	\$ 8,215.6	\$ 38,074.3

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on investment grade fixed maturity securities available-for-sale by aging category for the time periods indicated.

	Public		September 30, 2009 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 616.4	\$ 12.8	\$ 78.7	\$ 1.3	\$ 695.1	\$ 14.1
Greater than three to six months	61.9	0.5	46.4	8.2	108.3	8.7
Greater than six to nine months	136.8	10.7	100.4	7.4	237.2	18.1
Greater than nine to twelve months	230.7	19.7	298.1	25.0	528.8	44.7
Greater than twelve to twenty-four months	3,592.0	552.3	2,288.8	319.7	5,880.8	872.0
Greater than twenty-four to thirty-six months	1,721.7	354.7	1,459.8	364.3	3,181.5	719.0
Greater than thirty-six months	1,497.7	184.9	651.9	153.8	2,149.6	338.7
Total fixed maturity securities, available-for-sale	\$ 7,857.2	\$ 1,135.6	\$ 4,924.1	\$ 879.7	\$ 12,781.3	\$ 2,015.3

	Public		December 31, 2008 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 3,086.0	\$ 194.4	\$ 1,188.1	\$ 99.5	\$ 4,274.1	\$ 293.9
Greater than three to six months	4,213.7	467.9	1,673.6	236.4	5,887.3	704.3
Greater than six to nine months	3,014.0	620.7	1,566.6	290.6	4,580.6	911.3
Greater than nine to twelve months	2,321.0	743.0	1,259.7	460.1	3,580.7	1,203.1
Greater than twelve to twenty-four months	3,042.0	1,507.5	2,217.1	1,519.7	5,259.1	3,027.2
Greater than twenty-four to thirty-six months	1,045.2	296.1	312.5	217.1	1,357.7	513.2
Greater than thirty-six months	1,363.8	423.5	698.2	265.8	2,062.0	689.3
	\$ 18,085.7	\$ 4,253.1	\$ 8,915.8	\$ 3,089.2	\$ 27,001.5	\$ 7,342.3

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Total fixed maturity securities,
available-for-sale

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on below investment grade fixed maturity securities available-for-sale by aging category for the time periods indicated.

Table of Contents

	Public		September 30, 2009 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 3.3	\$ 0.1	\$ 14.7	\$ 0.1	\$ 18.0	\$ 0.2
Greater than three to six months	12.3	0.4	0.4	0.1	12.7	0.5
Greater than six to nine months	47.3	14.9	1.1	1.9	48.4	16.8
Greater than nine to twelve months	29.7	2.2	39.3	11.5	69.0	13.7
Greater than twelve to twenty-four months	761.2	255.8	471.8	278.9	1,233.0	534.7
Greater than twenty-four to thirty-six months	458.6	244.9	320.8	475.8	779.4	720.7
Greater than thirty-six months	169.6	41.1	93.7	47.3	263.3	88.4
Total fixed maturity securities, available-for-sale	\$ 1,482.0	\$ 559.4	\$ 941.8	\$ 815.6	\$ 2,423.8	\$ 1,375.0

	Public		December 31, 2008 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 133.1	\$ 56.5	\$ 114.6	\$ 32.1	\$ 247.7	\$ 88.6
Greater than three to six months	88.8	12.7	297.1	74.3	385.9	87.0
Greater than six to nine months	102.5	42.9	129.1	46.5	231.6	89.4
Greater than nine to twelve months	163.0	65.9	44.5	43.7	207.5	109.6
Greater than twelve to twenty-four months	242.0	151.7	351.8	239.5	593.8	391.2
Greater than twenty-four to thirty-six months	41.2	26.1	13.3	21.4	54.5	47.5
Greater than thirty-six months	100.3	29.7	100.9	30.3	201.2	60.0
Total fixed maturity securities, available-for-sale	\$ 870.9	\$ 385.5	\$ 1,051.3	\$ 487.8	\$ 1,922.2	\$ 873.3

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on fixed maturity securities available-for-sale where the estimated fair value has declined and remained below amortized cost by 20% or more as the time periods indicate.

	Problem, potential problem, and restructured		September 30, 2009 All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 0.9	\$ 0.4	\$ 44.4	\$ 15.4	\$ 45.3	\$ 15.8
Greater than three to six months	11.9	10.9	60.8	27.3	72.7	38.2
Greater than six to nine months	41.4	26.9	68.4	36.0	109.8	62.9
Greater than nine to twelve months	73.3	32.3	1,051.6	475.4	1,124.9	507.7
Greater than twelve months	169.0	291.3	1,617.1	1,679.0	1,786.1	1,970.3
	\$ 296.5	\$ 361.8	\$ 2,842.3	\$ 2,233.1	\$ 3,138.8	\$ 2,594.9

Total fixed maturity securities,
available-for-sale

105

Table of Contents

	Problem, potential problem, and restructured		December 31, 2008 All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 53.7	\$ 70.2	\$ 6,433.5	\$ 3,133.6	\$ 6,487.2	\$ 3,203.8
Greater than three to six months	27.5	28.5	1,374.2	1,314.6	1,401.7	1,343.1
Greater than six to nine months	6.1	14.5	279.3	415.5	285.4	430.0
Greater than nine to twelve months	11.5	10.3	486.8	904.1	498.3	914.4
Greater than twelve months	3.5	6.5	111.3	435.2	114.8	441.7
Total fixed maturity securities, available-for-sale	\$ 102.3	\$ 130.0	\$ 8,685.1	\$ 6,203.0	\$ 8,787.4	\$ 6,333.0

Mortgage Loans

Mortgage loans consist primarily of commercial mortgage loans on real estate. The carrying amount of our commercial mortgage loan portfolio was \$10,302.3 million and \$11,279.3 million as of September 30, 2009 and December 31, 2008, respectively. Commercial mortgage loans on real estate are generally reported at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances. Commercial mortgage loans held for sale are carried at the lower of cost or fair value, less cost to sell, and reported as mortgage loans in the statements of financial position.

Commercial mortgage loans play an important role in our investment strategy by:

- providing strong risk-adjusted relative value in comparison to other investment alternatives;
- enhancing total returns and
- providing strategic portfolio diversification.

As a result, we have focused on constructing a solid, high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Our commercial mortgage loan portfolio consists of primarily non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of credit oriented retail properties, manufacturing office properties and general-purpose industrial properties. In addition, we have a \$194.4 million and a \$261.3 million short-term high rate portfolio of mortgages held within the Global Asset Management segment as of September 30, 2009 and December 31, 2008, respectively.

Table of Contents

The following commercial mortgage portfolio is diversified by geographic region and specific collateral property for the periods indicated:

	September 30, 2009		December 31, 2008	
	Carrying amount	Percent of total	Carrying amount	Percent of total
	(\$ in millions)			
Geographic distribution				
New England	\$ 448.8	4.4%	\$ 459.4	4.1%
Middle Atlantic	1,613.6	15.7	1,794.8	15.9
East North Central	957.8	9.3	974.9	8.6
West North Central	515.0	5.0	550.0	4.9
South Atlantic	2,671.7	25.9	2,849.9	25.2
East South Central	312.7	3.0	323.2	2.9
West South Central	691.3	6.7	775.9	6.9
Mountain	825.6	8.0	900.3	8.0
Pacific	2,373.3	23.0	2,707.9	24.0
Valuation allowance	(107.5)	(1.0)	(57.0)	(0.5)
Total	\$ 10,302.3	100.0%	\$ 11,279.3	100.0%
Property type distribution				
Office	\$ 2,721.9	26.4%	\$ 2,894.7	25.7%
Retail	2,820.9	27.4	3,004.5	26.7
Industrial	2,483.1	24.1	2,688.1	23.8
Apartments	1,462.4	14.2	1,832.6	16.2
Hotel	498.4	4.8	507.0	4.5
Mixed use/other	423.1	4.1	409.4	3.6
Valuation allowance	(107.5)	(1.0)	(57.0)	(0.5)
Total	\$ 10,302.3	100.0%	\$ 11,279.3	100.0%

Credit extensions in the state of California accounted for 19% and 20% of our commercial mortgage loan portfolio as of September 30, 2009 and December 31, 2008, respectively. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building's design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses, by building and geographic fault lines, the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

Our commercial loan portfolio is highly diversified by borrower. As of September 30, 2009 and December 31, 2008, 31% and 30%, respectively, of the commercial mortgage loan portfolio was comprised of mortgage loans with principal balances of less than \$10.0 million. The total number of commercial mortgage loans outstanding was 1,137 and 1,223 as of September 30, 2009 and December 31, 2008, respectively. The average loan size of our commercial mortgage portfolio was \$9.1 million as of September 30, 2009 and \$9.3 million as of December 31, 2008.

Commercial Mortgage Loan Credit Monitoring. We actively monitor and manage our commercial mortgage loan portfolio. Substantially all loans within the portfolio are analyzed regularly and are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. Based on ongoing monitoring, mortgage loans with a likelihood of becoming delinquent are identified and

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

placed on an internal watch list. Among criteria which would indicate a potential problem are: imbalances in ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

We review our mortgage loan portfolio and analyze the need for a valuation allowance for any loan which is delinquent for 60 days or more, in process of foreclosure, restructured, on the watch list or which currently has a valuation allowance. We categorize loans that are 60 days or more delinquent, loans in process of foreclosure and loans to borrowers in bankruptcy that are delinquent as problem loans. Valuation allowances have been recognized on problem loans. Potential problem loans are loans placed on an internal watch list for which management has concerns as to the ability of the borrower to comply with the

Table of Contents

present loan payment terms and which may result in the loan becoming a problem or being restructured. The decision whether to classify a performing loan as a potential problem involves significant subjective judgments by management as to the likely future economic conditions and developments with respect to the borrower. We categorize loans for which the original Note Rate or Pay Rate of the mortgages have been reduced as restructured loans. We also consider matured loans that are refinanced at below market rates as restructured.

The following table presents the carrying amounts of problem, potential problem and restructured commercial mortgages relative to the carrying amount of all commercial mortgages for the periods indicated:

	September 30, 2009	December 31, 2008
	(\$ in millions)	
Total commercial mortgages	\$ 10,302.3	\$ 11,279.3
Problem commercial mortgages (1)	\$ 17.9	\$ 69.0
Potential problem commercial mortgages (2)	366.0	110.0
Restructured commercial mortgages (3)	17.8	5.5
Total problem, potential problem and restructured commercial mortgages	\$ 401.7	\$ 184.5
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	3.90%	1.64%

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

(1) Includes two mortgages held within the Global Asset Management segment as of September 30, 2009, and three mortgages held within the Global Asset Management segment as of December 31, 2008. One of these loans totaling \$15.0 million was in foreclosure as of September 30, 2009, and one mortgage loan totaling \$26.0 million was in foreclosure as of December 31, 2008. In addition, the Corporate segment holds one mortgage in foreclosure as of September 30, 2009.

(2) Potential problem commercial mortgages include \$55.9 million in mortgages held by the Global Asset Management segment at September 30, 2009, and \$48.0 million at December 31, 2008.

(3) Includes three mortgages held within the Global Asset Management segment totaling \$9.6 million at September 30, 2009, and one mortgage totaling \$5.5 million at December 31, 2008.

Commercial Mortgage Loan Valuation Allowance. The valuation allowance for commercial mortgage loans includes a loan specific allowance for impaired loans and a provision for losses based on past loss experience believed to be adequate to absorb estimated probable credit losses. The changes in the valuation allowance are reported in net income on our consolidated statements of operations.

Commercial mortgage loans on real estate are considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine that a loan is impaired, a valuation allowance is established for the difference between the carrying amount of the mortgage loan and the estimated value. Estimated value is based on either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or fair value of the collateral.

When a valuation allowance is established, subsequent recoveries are credited to the valuation allowance and subsequent losses may be charged to the valuation allowance. The determination of the calculation and the adequacy of the mortgage loan loss provision based on past experience and current portfolio statistics are subjective. Our periodic evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. Our financial position is sensitive to changes in estimated cash flows from mortgages, the value of the collateral and changes in the economic environment in general. The valuation allowance for PFG increased by \$50.5 million for the nine months ended September 30, 2009, and increased by \$14.2 million for the year ended December 31, 2008. The increase in the reserve includes \$33.8 million related to mortgages held within the Principal Life Insurance Company general account and \$14.1 million related to mortgages held within the Global Asset Management segment for the nine months ended September 30, 2009. The reserve related to mortgages held within the Global Asset Management segment increased \$16.1 million for the year ended December 31, 2008.

Table of Contents

The following table represents our commercial mortgage valuation allowance for the periods indicated:

	September 30, 2009	December 31, 2008
	(\$ in millions)	
Balance, beginning of period	\$ 57.0	\$ 42.8
Provision	89.6	42.9
Releases	(39.1)	(28.7)
Balance, end of period	\$ 107.5	\$ 57.0
Valuation allowance as % of carrying value before reserves	1.03%	.50%

Real Estate

Real estate consists primarily of commercial equity real estate. As of September 30, 2009 and December 31, 2008, the carrying amount of our equity real estate investment was \$1,012.8 million, or 2%, and \$915.2 million, or 1%, of U.S. invested assets, respectively. Our commercial equity real estate is held in the form of wholly owned real estate, real estate acquired upon foreclosure of commercial mortgage loans and majority owned interests in real estate joint ventures.

Equity real estate is categorized as either real estate held for investment or real estate held for sale. Real estate held for investment totaled \$993.9 million and \$779.8 million as of September 30, 2009 and December 31, 2008, respectively. The carrying value of real estate held for investment is generally adjusted for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized losses and, accordingly, are reflected in our consolidated results of operations. For the nine months ended September 30, 2009 and for the year ended December 31, 2008, there were no such impairment adjustments.

The carrying amount of real estate held for sale as of September 30, 2009, was \$18.9 million. There were no valuation allowances as of September 30, 2009. The carrying amount of real estate held for sale as of December 31, 2008, was \$135.4 million, net of valuation allowance of \$3.5 million. Once we identify a real estate property to be sold and commence a plan for marketing the property, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Equity real estate is distributed across geographic regions of the country with larger concentrations in the South Atlantic and West South Central regions of the United States as of September 30, 2009. By property type, there is a concentration in office, industrial site buildings, and retail that represented approximately 77% of the equity real estate portfolio as of September 30, 2009.

Other Investments

Our other investments totaled \$1,682.6 million as of September 30, 2009, compared to \$2,162.4 million as of December 31, 2008. Derivative assets accounted for \$1,431.4 million in other investments as of September 30, 2009. The remaining invested assets include equity method investments, which include properties owned jointly with venture partners and operated by the partners.

Table of Contents**International Investment Operations**

Of our invested assets, \$4.1 billion were held by our International Asset Management and Accumulation segment as of September 30, 2009. Our international investment operations consist of the investments of Principal International. Principal Global Investors advises each Principal International affiliate on investment policies and strategies that are consistent with the products they offer. Due to the regulatory constraints in each country, each company maintains its own investment policies. As shown in the following table, the major categories of international invested assets as of September 30, 2009 and December 31, 2008, were fixed maturity securities, other investments and residential mortgage loans. The following table excludes invested assets of the separate accounts.

	September 30, 2009		December 31, 2008	
	Carrying amount	% of total	Carrying amount	% of total
(\$ in millions)				
Fixed maturity securities Public	\$ 2,573.2	63%	\$ 2,134.2	64%
Equity securities	43.4	1	40.8	1
Mortgage loans Residential	543.2	13	479.9	14
Real estate	12.1		4.2	
Policy loans	19.0	1	15.0	1
Other investments	870.6	22	654.2	20
Total invested assets	4,061.5	100%	3,328.3	100%
Cash and cash equivalents	34.8		71.0	
Total invested assets and cash	\$ 4,096.3		\$ 3,399.3	

Investments in equity method subsidiaries and direct financing leases accounted for \$511.2 million and \$319.4 million, respectively, of other investments as of September 30, 2009. Investments in equity method subsidiaries and direct financing leases accounted for \$377.2 million and \$265.4 million, respectively, of other investments as of December 31, 2008. We are in the process of negotiating the terms of renewal for our joint venture in Brazil, which is reported as an equity method subsidiary. The remaining other investments as of September 30, 2009, and December 31, 2008, are primarily related to other short-term investments and derivative assets.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk Exposures and Risk Management

Market risk is the risk that we will incur losses due to adverse fluctuations in market rates and prices. Our primary market risk exposure is to changes in interest rates, although we also have exposures to changes in equity prices and foreign currency exchange rates.

We enter into market-sensitive instruments for purposes other than trading. The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges by using the following approaches:

- rebalance our existing asset or liability portfolios;
- control the risk structure of newly acquired assets and liabilities or
- use derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

Interest Rate Risk

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. One source of interest rate risk is the inherent difficulty in obtaining assets that mature or have their rate reset at the exact same time as the liabilities they support. Assets may have to be reinvested or sold in the future to meet the liability cash flows in unknown interest rate environments. Secondly, there may be timing differences between when new liabilities are priced and when assets are purchased or procured that can cause fluctuations in profitability if interest rates move materially in the interim. A third source of

Table of Contents

interest rate risk is the prepayment options embedded within asset and liability contracts that can alter the cash flow profiles from what was originally expected.

One of the measures we use to quantify our exposure to interest rate risk is duration. To calculate duration, we project asset and liability cash flows. These cash flows are discounted to a net present value basis using a spot yield curve, which is a blend of the spot yield curves for each of the asset types in the portfolio. Duration is calculated by re-calculating these cash flows, re-determining the net present value based upon an alternative level of interest rates, and determining the percentage change in fair value.

We manage interest rate risks in a number of ways. Differences in durations between assets and liabilities are measured and kept within acceptable tolerances. Derivatives are also commonly used to mitigate interest rate risk due to cash flow mismatches and timing differences. Prepayment risk is controlled by limiting our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer. We also require additional yield on these investments to compensate for the risk the issuer will exercise such option. Prepayment risk is also controlled by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times. For example, approximately \$16.1 billion, or 99%, of our institutional GICs and funding agreements cannot be redeemed by contractholders prior to maturity.

We are also exposed to interest rate risk based upon the discount rate assumption used for purposes of valuing our employee pension and other post-retirement benefit obligations.

Duration-Managed. Our exposure to interest rate risk stems largely from our substantial holdings of guaranteed fixed rate liabilities in our U.S. Asset Accumulation segment. We actively manage the duration of assets and liabilities in these products by minimizing the difference between the two. We have established a maximum tolerance for this difference and seek to stay within this tolerance.

As of September 30, 2009, the difference between the asset and liability durations on our primary duration-managed portfolio was -0.14, as compared to -0.17 as of December 31, 2008. This duration gap indicates that, as of September 30, 2009, the sensitivity of the fair value of our assets to interest rate movements is less than that of the fair value of our liabilities. Our goal is to minimize the duration gap. Currently, our guidelines indicate that total duration gap between the asset and liability portfolios should be within +/-0.25. The value of the assets in this portfolio was \$29,356.1 million and \$29,440.1 million as of September 30, 2009 and December 31, 2008, respectively.

Duration-Monitored. For products such as whole life insurance and term life insurance that are less sensitive to interest rate risk, and for other products such as individual fixed annuities, we manage interest rate risk based on a modeling process that considers the target average life, maturities, crediting rates and assumptions of policyholder behavior. As of September 30, 2009, the weighted-average difference between the asset and liability durations on these portfolios was +0.01, as compared to +0.09 as of December 31, 2008. This duration gap indicates that, as of September 30, 2009, the sensitivity of the fair value of our assets to interest rate movements is greater than that of the fair value of our liabilities. We attempt to monitor this duration gap consistent with our overall risk/reward tolerances. The value of the assets in these portfolios was \$21,937.7 million and \$18,017.3 million as of September 30, 2009 and December 31, 2008, respectively.

Non Duration-Managed. We also have a block of participating general account pension business that passes most of the actual investment performance of the assets to the customer. The investment strategy of this block is to maximize investment return to the customer on a best

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

efforts basis, and there is little or no attempt to manage the duration of this portfolio since there is little or no interest rate risk. The value of the assets in these portfolios was \$4,892.2 million and \$4,866.0 million as of September 30, 2009 and December 31, 2008, respectively.

Using the assumptions and data in effect as of September 30, 2009, we estimate that a 100 basis point immediate, parallel increase in interest rates increases the net fair value of our portfolio by approximately \$40.7 million, compared with an estimated \$34.0 million increase as of December 31, 2008. The following table details the estimated changes by risk management strategy. The table also gives the weighted-average duration of the asset portfolio for each category, and the net duration gap (i.e., the weighted-average difference between the asset and liability durations).

Table of Contents

Risk Management Strategy	September 30, 2009			
	Value of total assets (in millions)	Duration of assets	Net duration gap	Net fair value change (in millions)
Primary duration-managed	\$ 29,356.1	3.37	(0.14)	\$ 41.8
Duration-monitored	21,937.7	4.24	0.01	(1.1)
Non duration-managed	4,892.2	4.72	N/A	N/A
Total	\$ 56,186.0			\$ 40.7

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing portfolio transactions in response to new business, management's assessment of changing market conditions and available investment opportunities.

Debt Issued and Outstanding. The aggregate fair value of long-term debt was \$1,646.9 million and \$1,096.1 million, as of September 30, 2009 and December 31, 2008, respectively. As of September 30, 2009, a 100 basis point immediate, parallel decrease in interest rates would increase the fair value of debt by approximately \$139.2 million, as compared to an estimated \$59.4 million increase as of December 31, 2008. Debt is not recorded at fair value on the statement of financial position.

Using the assumptions and data in effect as of September 30, 2009, we estimate that a 100 basis point immediate, parallel decrease or increase in interest rates would increase or decrease, respectively, the fair value for each category of long-term debt as presented in the following table.

	September 30, 2009		
	-100 basis point change	Fair value (no accrued interest) No change (in millions)	+100 basis point change
3.31% notes payable, due 2011	\$ 61.6	\$ 60.3	\$ 59.1
3.63% notes payable, due 2011	31.8	31.1	30.5
7.875% notes payable, due 2014	460.0	442.2	425.2
8.875% notes payable, due 2019	449.4	419.4	391.8
6.05% notes payable, due 2036	633.8	555.1	490.5
8% surplus notes payable, due 2044	100.4	91.4	83.2
Non-recourse mortgages and notes payable	48.5	46.8	46.9
Other mortgages and notes payable	0.6	0.6	0.6
Total long-term debt	\$ 1,786.1	\$ 1,646.9	\$ 1,527.8

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase or decrease does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our long-term debt obligations at a point in time and may not be representative of future obligations. These exposures will change as a result of ongoing changes to our outstanding long-term debt obligations.

Use of Derivatives to Manage Interest Rate Risk. We use or have previously used various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, swaptions, futures, treasury lock agreements and options. We use interest rate swaps and futures contracts to hedge changes in interest rates subsequent to the issuance of an insurance liability, such as a guaranteed investment contract, but prior to the purchase of a supporting asset, or during periods of holding assets in anticipation of near term liability sales. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities. They can be used to change the sensitivity to the interest rate of specific assets and liabilities as well as an entire portfolio. Occasionally, we have sold a callable investment-type agreement and used written interest rate swaptions to transform the callable liability into a fixed term liability.

Table of Contents

The following table shows the interest rate sensitivity of our derivatives measured in terms of fair value. These exposures will change as a result of ongoing portfolio and risk management activities.

	Notional amount	Weighted average term (years) (1)	September 30, 2009		
			Fair value (no accrued interest)		
			-100 basis point change (\$ in millions)	No change	+100 basis point change
Interest rate swaps	\$ 23,287.3	5.47	\$ (216.2)	\$ (170.9)	\$ (146.4)
Futures	27.3	0.41	(1.9)	0.3	2.4
Total	\$ 23,314.6		\$ (218.1)	\$ (170.6)	\$ (144.0)

- (1) Based on maturity date.

We use U.S. Treasury futures to manage our over/under commitment position, and our position in these contracts changes daily.

Foreign Currency Risk

Foreign currency risk is the risk that we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements issued to nonqualified institutional investors in the international market, foreign currency-denominated fixed maturity securities and demand deposits purchased and our international operations.

We estimate that as of September 30, 2009, a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we are exposed would result in no material change to the net fair value of our foreign currency denominated instruments identified above because we effectively hedge foreign currency denominated instruments to minimize exchange rate impacts, which is consistent with our estimate as of September 30, 2008. However, fluctuations in foreign currency exchange rates do affect the translation of local operating earnings and equity into our consolidated financial statements.

For our International Asset Management and Accumulation segment, we estimate that a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we were exposed would have resulted in a \$124.1 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of September 30, 2009, as compared to an estimated \$100.3 million, or 10%, reduction as of December 31, 2008. We estimate that a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a \$3.5 million, or 11%, reduction in the quarterly operating earnings of our international operations for the three months ended September 30, 2009, as compared to an estimated \$4.7 million, or 11%, reduction for the three months ended September 30, 2008. In addition, a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in an \$8.7 million, or 11%, reduction in the operating earnings of our international operations for the nine months ended September 30, 2009, as compared to an estimated \$10.7 million, or 10%, reduction for the nine months ended September 30, 2008.

The selection of a 10% immediate unfavorable change in all currency exchange rates should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. These exposures will change as a result of a change in the size and mix of our foreign operations.

Use of Derivatives to Manage Foreign Currency Risk. The foreign currency risk on funding agreements and fixed maturity securities is mitigated by using currency swaps that swap the foreign currency interest and principal payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities was \$3,415.0 million and \$4,269.2 million as of September 30, 2009 and December 31, 2008, respectively. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturity securities was \$1,970.6 million and \$2,005.4 million as of September 30, 2009 and December 31, 2008, respectively.

With regard to our international operations, we attempt to do as much of our business as possible in the functional currency of the country of operation. At times, however, we are unable to do so, and in these cases, we use foreign exchange derivatives to economically hedge the resulting risks. Our operations in Chile had currency swaps with a notional amount of \$24.1 million as of both September 30, 2009 and December 31, 2008, which were used to swap cash flows on U.S.

Table of Contents

dollar-denominated bonds to a local currency. Chile also utilized currency forwards with a notional amount of \$91.6 million and \$52.1 million as of September 30, 2009 and December 31, 2008, respectively, in order to mitigate currency exposure related to bonds denominated in currencies other than Chilean pesos.

Additionally, from time to time we take measures to hedge our net equity investments in our foreign subsidiaries from currency risks. There were no outstanding net equity investment hedges in 2009 or 2008.

Equity Risk

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in a particular common stock. As of September 30, 2009 and December 31, 2008, the fair value of our equity securities was \$397.2 million and \$400.7 million, respectively. As of September 30, 2009, a 10% decline in the value of the equity securities would result in an unrealized loss of \$39.7 million, as compared to an estimated unrealized loss of \$40.1 million as of December 31, 2008.

We are also exposed to the risk that asset-based fees decrease as a result of declines in assets under management due to change in investment prices and the risk that asset management fees calculated by reference to performance could be lower. We estimate that an immediate 10% decline in the Standard & Poor's index, followed by a 2% per quarter increase would reduce our annual operating earnings by approximately four to six percent. The risk of decreased asset-based and asset management fees could also impact our estimates of total gross profits used as a basis for amortizing deferred policy acquisition and other costs.

The selection of a 10% unfavorable change in the equity markets should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. Our exposure will change as a result of changes in our mix of business.

We also have equity risk associated with (1) fixed deferred annuity contracts that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a GMWB rider that allows the customer to receive at least the principal deposit back through withdrawals of a specified annual amount, even if the account value is reduced to zero; (3) variable annuity contracts that have a guaranteed minimum death benefit (GMDB) that allows the death benefit to be paid, even if the account value has fallen below the GMDB amount; (4) investment-type contracts in which the return is tied to an external equity index and (5) investment-type contracts in which the return is subject to minimum contractual guarantees. We are also subject to equity risk based upon the assets that support our benefit plans.

Use of Derivatives to Manage Equity Risk. We economically hedge the fixed deferred annuity product by purchasing options that match the product's profile. We economically hedge the GMWB exposure using futures, options and interest rate swaps. We economically hedge the investment contract exposure to an external equity index using equity call options.

The fair value of both the GMWB embedded derivative and associated hedging instruments are sensitive to financial market conditions and the variance related to the change in fair value of these items for a given period is largely dependent on market conditions at the end of the period. We recognized a pre-tax gain (loss) on the change in fair value of the GMWB embedded derivative of \$(17.4) million and \$4.1 million for the

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

three months ended September 30, 2009 and 2008, respectively, and \$(7.2) million and \$6.2 million for the nine months ended September 30, 2009 and 2008, respectively. We recognized a pre-tax gain (loss) on the derivatives used to economically hedge our GMWB market risk, which includes equity risk, of \$(11.3) million and \$17.9 million for the three months ended September 30, 2009 and 2008, respectively, and \$(140.2) million and \$22.7 million for the nine months ended September 30, 2009 and 2008, respectively. The implementation of SFAS 157 in 2008 resulted in the incorporation of a spread reflecting our own creditworthiness and additional risk margins in the valuation of the GMWB embedded derivative. Throughout the latter part of 2008 and continuing into the first quarter of 2009, the spread reflecting our own credit risk increased, which drove a significant increase in the discount rates applied, thereby reducing the fair value of the embedded derivative liability. During the second and third quarters of 2009, the spread reflecting our own credit risk decreased, thereby increasing the fair value of the embedded derivative liability to somewhat offset the decrease in fair value of the embedded derivative liability that occurred in late 2008 and the first quarter of 2009. In 2009, this resulted in the income statement impact from the changes in fair value of the embedded derivative being different than the income statement impact from the changes in fair value of the associated hedging instruments. Additionally, reflecting the actual and expected changes in value of the GMWB embedded derivative and the associated hedging instruments in our gross profits resulted in a \$16.9 million and \$52.8 million pre-tax decrease in DPAC amortization for the three and nine months ended September 30, 2009, respectively. For the three and nine months ended September 30, 2008, the impact on DPAC amortization was not material.

Table of Contents

Credit Risk

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. Our ability to manage credit risk is essential to our business and our profitability. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Investments for additional information about credit risk.

Use of Derivatives to Diversify or Hedge Credit Risk. We purchase credit default swaps to hedge credit exposures in our investment portfolio. We sell credit default swaps to offer credit protection to investors. When selling credit protection, if there is an event of default by the referenced name, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security. For further information on credit derivatives sold, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Derivative Financial Instruments.

We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of \$448.5 million and \$549.0 million as of September 30, 2009 and December 31, 2008, respectively. We had credit exposure through credit default swaps with a notional amount of \$189.4 million and \$200.0 million as of September 30, 2009 and December 31, 2008, respectively, by investing in various tranches of synthetic collateralized debt obligations. In addition, we sold credit default swaps creating replicated assets with a notional amount of \$1,136.9 million and \$1,199.9 million as of September 30, 2009 and December 31, 2008, respectively.

Derivative Counterparty Risk

In conjunction with our use of derivatives, we are exposed to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- obtaining approval of all new counterparties by the Investment Committee;

- establishing exposure limits which take into account non-derivative exposure we have with the counterparty as well as derivative exposure;

- performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;

- diversifying our risk across numerous approved counterparties;

- limiting exposure to A+ credit or better;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;
- implementing credit support annex (collateral) agreements with selected counterparties to further limit counterparty exposures, which provide for netting of exposures, and
- daily monitoring of counterparty credit ratings, exposure and associated collateral levels.

We believe the risk of incurring losses due to nonperformance by our counterparties is manageable. For further information on derivatives, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Derivative Financial Instruments.

Based on our accounting policy, our disclosed exposure measures the fair value of derivatives that have become favorable to us and, therefore, is a combined credit exposure if all of the involved counterparties failed to fulfill their obligations. In the hypothetical scenario where all of our counterparties fail to fulfill their obligations, our exposure would be \$1,578.5 million; however, including collateral received our exposure would be reduced to \$1,161.0 million. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Derivative Financial Instruments under the caption, Exposure.

Table of Contents

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. Netting positive and negative exposures would yield an exposure of \$506.8 million, which is reduced to \$89.3 million with pledged collateral at September 30, 2009. As of September 30, 2009, we held total collateral of \$417.5 million in the form of cash and securities and we posted \$301.9 million in cash and securities as collateral to our counterparties. We have not incurred any material losses on derivative financial instruments due to counterparty nonperformance. As of September 30, 2009, any deterioration in our derivative counterparties' credit would not materially impact our financial statements.

Effects of Inflation

The impact of inflation in the United States or in the other countries in which we operate, has not had a material effect on our annual consolidated operations over the past three years. However, we may be materially affected by inflation in the future.

Item 4. Controls and Procedures

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Disclosure Controls and Procedures

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer, Larry D. Zimpleman, and our Chief Financial Officer, Terrance J. Lillis, have reviewed and evaluated our disclosure controls and procedures as of September 30, 2009, and have concluded that our disclosure controls and procedures are effective.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Contingencies, Guarantees and Indemnifications under the caption, Litigation and Regulatory Contingencies, which is incorporated here by this reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, consideration should be given to the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008. If any of those factors were to occur, they could materially adversely affect our business, financial condition or future results, and could cause actual results to differ materially from those expressed in forward-looking statements in this report. We are not aware of any material changes to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2008.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table presents the amount of our common share purchase activity for the periods indicated:

Issuer Purchases of Equity Securities

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Period	Total number of shares (or units) purchased (1)	Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs (in millions) (2)
January 1, 2009 - January 31, 2009	1,697	\$ 22.13	\$	250.0
February 1, 2009 - February 28, 2009	136,948	\$ 16.83	\$	250.0
March 1, 2009 - March 31, 2009	67,054	\$ 9.56	\$	250.0
April 1, 2009 - April 30, 2009	20,532	\$ 8.63	\$	250.0
May 1, 2009 - May 31, 2009	851	\$ 18.86	\$	250.0
June 1, 2009 - June 30, 2009	27,189	\$ 18.94	\$	250.0
July 1, 2009 - July 31, 2009	16,482	\$ 18.84	\$	250.0
August 1, 2009 - August 31, 2009	649	\$ 25.09	\$	250.0
September 1, 2009 - September 30, 2009		\$	\$	250.0
Total	271,402			

(1) Reflects the number of shares of common stock utilized to execute certain stock incentive awards in 2009.

(2) During November 2007, our Board of Directors authorized a share repurchase program of up to \$500.0 million of our outstanding common stock. As of September 30, 2009, \$250.0 million remained under the November 2007 authorization. We suspended purchases of our common stock effective October 13, 2008, under the existing share repurchase program.

Table of Contents

Item 6. Exhibits

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Exhibit Number	Description
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Larry D. Zimpleman
31.2	Certification of Terrance J. Lillis
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis
101	The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text.

Table of Contents

SIGNATURE

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRINCIPAL FINANCIAL GROUP, INC.

Dated: November 4, 2009

By

/s/ Terrance J. Lillis
Terrance J. Lillis
Senior Vice President and Chief Financial Officer

Duly Authorized Officer, Principal Financial Officer,
and Chief Accounting Officer

Table of Contents**Exhibit Index**

Exhibit Number	Description
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Larry D. Zimpleman
31.2	Certification of Terrance J. Lillis
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis
101	The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text.